Supreme Court of the United States

OCTOBER TERM, 1947.

No. 405

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

MANUFACTURERS TRUST COMPANY, Indenture Trustee,
Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION
and CONSOLIDATED REALTY CORPORATION,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND SUPPORTING BRIEF FOR MANUFACTURERS TRUST COMPANY, AS INDENTURE TRUSTEE.

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NEWMAN & BISCO,
Attorneys for Petitioner.

THE COURT PRESS, N. Y. C.

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Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and the Associated Justices of the Supreme Court of the United States:

Your petitioner, Manufacturers Trust Company, a corporation organized and existing under the Banking Law of the State of New York, with principal office at 55 Broad Street, City of New York, New York, prays that a writ of certiorari be issued to the United

States Circuit Court of Appeals for the Second Circuit to review a judgment of that Court entered in the above entitled matter on July 23, 1947 upon decision of Judge Thomas W. Swan concurred in by Judge Learned Hand [Judge Charles E. Clark dissenting in separate opinion], which reversed and modified so much of the order of the District Court of the United States for the Eastern District of New York dated August 5, 1946 as allowed 6% interest on the bondholders' claim against the solvent debtor from the maturity of their bonds and affirmed so much of said order as related to the application of an interim payment of interest, and respectfully shows and represents as follows:

Summary and Short Statement of the Matter Involved.

The facts of this matter are not in dispute.

In 1928 debtor, a corporation dealing in real estate, mortgages and securities, had outstanding three series of unsecured coupon bonds totalling $15,000,000 which carried 6% interest "until payment of the principal". Thus a major portion of its assets represented and continued to represent capital borrowed from some 2100 bondholders.

In a composition in bankruptcy dated as of July 10, 1933, the bonds were reduced by cash payment and modified and extended to October 1, 1943 by Supplemental Indenture with Manufacturers Trust Company, the Indenture Trustee, (hereinafter also referred to as the indenture). Coupons were detached and the bonds registered and stamped to indicate the modifications. Thereafter, interest at the rate

of 5% was payable currently from earnings. Unpaid interest was cumulative and payable with principal punctually at maturity or whenever principal might theretofore become due.*

Debtor's Profitable Operations in Its Bonds and Deliberate Default at Maturity.

In the ensuing ten year period debtor took advantage of a peculiar definition of "Earnings" (R 94-95) to pay interest at the rate of but 3%. It thus deferred payment of 2% interest which accumulated to $1,286,646.43 at maturity. This withholding, deferment and accumulation of interest enabled debtor to buy in bonds of a face value of $4,888,175, at depressed values, for but $2,178,044.13, with a consequent profit of about $2,700,000, and cancellation of

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* Pertinent Provisions of the 1933 Supplemental Indenture.

Debtor, instead of the 5% contract rate of interest "until payment of the principal", newly covenanted to pay interest "until the reduced principal on each such Bond shall be duly paid". Article III Section 1 (R 92) and newly promised to "duly and punctually pay the principal . . . together with interest . . . not theretofore paid, on October 1, 1943". Article IV Section 1 (R 99).

It agreed unconditionally that after October 1, 1943, any registered bondholder might sue in his own right to recover principal or interest. Article VI Section 8 (R 122) and Certificates of Modification as issued to bondholders (R 80). All other rights of action vested in the Trustee, whose several separate and distinct remedies provided in Article VI, Section 1, were conditional and not to be exercised in any instance without certain conditions precedent (R 117-118). Any sum so collected by such Trustee was to be applied to the whole amount then unpaid with interest at 5% on overdue principal only (R 119-20).

No declaration of default, no condition precedent and no collection by the Indenture Trustee has taken place herein.

those bonds would have shown a book value surplus of $2,500,000 (Appendices to Brief, pages b2-b7).*

Debtor, though possessed of assets exceeding $13,000,000, including cash of $1,250,000 and legals of a then market value of $1,760,069 (Appendices page b3), omitted provision for payment of the principal or unpaid accumulated interest due on its bonds at maturity.

Instead, on September 28, 1943, three days before the maturity date, debtor filed petition for reorganization under Chapter X listing no other debts save minor current bills (Appendices page b4).

As a Result of the Chapter X Proceeding Debtor's Estate Was Enriched by the Use of and the Vast Income from Moneys Withheld from Bondholders after Maturity.

The order approving the petition stayed bondholders as well as the Indenture Trustee from bringing suit at maturity and immediately reducing all claims to judgment bearing 6% in the State of New York. Thereafter and until April 15, 1945 debtor not only stood in default of the principal and accumulated interest due at maturity but also of any interest thereon, except such as was allowed by Court order.

At maturity on October 1, 1943, the publicly held bonds amounted to $5,710,400 on which unpaid interest at 2% per annum had accumulated to $1,286,646.43, as aforesaid. The total $6,997,046.43 constituted the admitted claim of bondholders.

Debtor's estate consisted mostly of mortgages, securities and interest-bearing or income-producing assets. But no part of the $1,286,646.43 in accumulated and

*Paragraph 5 of debtor's petition also shows that of $2,414,528.55 accumulated interest shown as a "Liability", $1,113,606.12 represented interest on the bonds so acquired (Appendices, page b5).

unpaid interest, and no interest thereon, was paid during the proceedings.* That sum as well as the vast income therefrom were profitably used in debtor's business throughout the proceedings. Debtor's financial position thus greatly improved during the Chapter X proceeding (R 144) and this aided debtor in finally borrowing and refunding through its sole stockholder, Consolidated Realty Corporation, a subsidiary of Reconstruction Finance Corporation.

Early in the proceedings the holders of an insignificant portion of the bonds (less than 1/5 of 1%) moved to dismiss the petition for lack of "good faith". The motion was denied and no appeal taken.

The Solvent Debtor Finally Refunded Through its Stockholder.

In March 1945 debtor and its stockholder by joint application sought leave to pay the bonds in full by said refunding, disclaiming liability as to any interest in excess of 5% on principal. In order to obtain immediate dismissal and release of the business and assets from court regulation and restrictions, they proposed a "Trustees' Reserve" to cover any additional amount of interest which might be allowed bondholders (R 13, 19, 22).

By Order entered April 2, 1945, the District Court dismissed the proceedings, provided for payment on April 15, 1945 of the principal amount of the bonds and interest thereon at the contract rate of 5% together with the unpaid accumulated interest due at

* Partial payments of current interest at the rate of 3%, as ordered from time to time during the proceedings, were based only on the face amount of the bonds, viz: $5,710,000. The only payments on the claim were two partial payments on account of principal totalling 35% thereof.

maturity. It also set up the reserve proposed by debtor and retained jurisdiction to determine [1] whether, after default at maturity, bondholders were entitled to interest at the contract rate of 5% or at the legal rate of 6%, and [2] whether interest should be paid on the $1,286,646.43 portion of the claim representing the ten year accumulation of unpaid interest which had become due at maturity (R 26, 33, 38).

Ruling of the District Court.

The District Court thereafter determined said questions in the affirmative, and petitioner here quotes, as apposite to matters hereinafter discussed, the following portions of its decision:

> "To adopt debtor's construction would require entirely reading out of the agreement the word 'duly'. (R 175)
>
> Article III. Section 1 is plain and unequivocal when read in conjunction with the particular covenant of Article IV. But even assuming *arguendo* that Article VI be deemed to create an ambiguity . . . such ambiguity would have to be resolved in favor of the bondholders . . . (R 176)
>
> To compound interest means to add to the principal at the end of each interest period the amount of the interest for that period so as repeatedly to broaden the base upon which future interest is computed . . . no interest is sought on installments of interest . . . (R 178)
>
> The bondholders' claim in the instant case is only for simple interest upon a debt which has become due and is therefore not contrary to public policy. (R 179)

> The admitted liability of the debtor thus constituted the equivalent of one claim for $6,997,046.43 . . . since the bonds were by their terms interest bearing, the interest which matured with the principal on October 1, 1943, constituted an equally integral part of the same claim.
>
> There is no basis for recognizing any distinction between these two parts of the claim." (R 180)

The order of August 5, 1946, allowed interest at the rate of 6% upon the whole of bondholders claim from October 1, 1943, the due date. Debtor and its stockholder appealed therefrom. As Indenture Trustee, petitioner appealed as to the application made in said order of the first interim interest payment and the computation of interest thereon (R 189-197).

THE DISSENT IN THE CIRCUIT COURT OF APPEALS.

The Circuit Court of Appeals, Second Circuit, by divided Court, reversed the District Court in respect to the interest questions and declined consideration of the interim interest issue as academic (R 211-218). The errors inherent in the judgment below sufficiently appear from the following portions of this petition and annexed Brief. The prevailing opinion conceded that debtor's assets seemed ample to pay bondholders at maturity, and Judge Clark, dissenting, succinctly stated the case as follows:

> "This is now a contest between a solvent debtor and its creditors over a direct obligation which has become fixed and final . . . It should not be affected by the abortive reorganization proceed-

> ings. . . . The situation is one therefore where a debtor who has availed himself of the bankruptcy provisions ultimately is able to pay in full; he should not then be permitted to make use of the statute to reduce his claim. Obviously here, except for the proceedings, the creditors would have taken judgment at once; they should not be deprived of that advantage by the debtor's unassented-to act (R 218).
>
> That this was a reorganization, rather than an ordinary bankruptcy, proceeding would seem not to change this situation. It is still only a question between the debtor and its creditors. The cases in railroad reorganization were cases involving equities between classes of creditors. The *Vanston* case, *supra,* 329 U. S. 156, 164, 165, is, I believe, important authority for this view . . . These views would mean that at least from the time of allowance, the claim, including the interest due thereon at the time, would bear interest at the legal rate of 6 per cent" (R 219).

The judgment of the Circuit Court of Appeals dated July 23, 1943, directed that the order of the District Court, which covered other matters, be modified (R 209-222). Petitioner seeks review of said judgment in all respects.

Jurisdiction.

Jurisdiction is invoked under Section 24, Subdivisions a and c, of the Bankruptcy Act (11 U. S. C. A. 47 a and c) and Section 240, Subdivision a, of the Judicial Code, as amended by Act of February 13, 1925 (28 U. S. C. A. 347a).

The Statute Involved.

The Statute involved is the Bankruptcy Act, Chapter X, Section 102 [providing for the application in Chapter X proceedings of other provisions of the Act relating to straight bankruptcy, which need not be set forth at length], and the following Sections:

> 106. For the purposes of this chapter, unless inconsistent with the context—(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;
>
> 114. Upon the approval of a petition, the jurisdiction, powers, and duties of the court and of its officers, where not inconsistent with the provisions of this chapter, shall be the same as in a bankruptcy proceeding upon adjudication.
>
> 115. Upon the approval of a petition, the court shall have and may, . . . exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.
>
> 200. Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, . . . upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.

The Questions Presented.

1. Whether in a Chapter X proceeding as a matter of Federal law relating to distribution of assets:

a. the rights of creditors are any less than in straight bankruptcy or equity receivership proceedings, or do the same principles govern the allowance of interest?[1]

b. interest may be allowed on an allowed claim consisting of principal and accumulated accrued interest which became due at or about the time of the filing of the petition? And if so, what governs the rate of such interest?

c. the allowance of interest during the proceeding on bondholders' matured claim is in any manner dependent upon or controlled or limited by the local laws?

d. a solvent debtor obtains a moratorium without obligation to pay interest on allowed claims, unless provided for by contract?

e. interest can be denied on an entire claim where a solvent debtor has defaulted in payment of principal with interest due at maturity and failed to pay even the full contract rate due after maturity until more than eighteen months after maturity?

f. in determining allowance of interest in a voluntary proceeding by a solvent debtor having but

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[1] "A Chapter X Reorganization Court is just as much a court of equity as its statutory antecedents." (*Vanston Bondholders Pro. Com.* v. *Green*, 329 U. S. 156; *Johnson* v. *Norris*, 190 Fed. 459 C. C. A. 5th; *Ohio Savings Bank and Trust Co.* v. *Willys Corp. et al.*, 8 F. 2nd 463 C. C. A. 2d.)

one class of creditors [where the balance of equities is between debtor and its creditors], it is error (a) to apply the principles governing the allowance of interest upon claims in cases of insolvent debtors[2] [where the balance of equities is between creditor and creditor], or (b) to follow cases where the maturity dates of the obligations did not arrive until long after the filing of the petition[3]—in none of which does the precise question as to creditors right to legal interest against an estate able to pay it, appear to have been raised?

2. Whether the Circuit Court of Appeals has properly interpreted and applied the law of the State of New York insofar as same affects the rights of the debtor or its bondholders?

3. Whether the Circuit Court of Appeals properly balanced the equities between bondholders and the debtor?

4. To what extent and at what rate, interest is payable in respect of bondholders' claim.[4]

5. Whether the District Court in its order of August 5, 1946 made proper application or disposition of the partial interim interest payment of January 1, 1944?*

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[2] *Ecker* v. *Western Pacific R. R. Corp.*, 318 U. S. 448; *Brooks* v. *St. Louis-San Francisco Ry. Co.*, 153 F. 2d 312; *Chicago, Milwaukee, St. Paul & Pacific R. R. Co.*, Reorganization, 254 I. C. C. 707.

[3] *In re McKesson & Robbins, Inc.*, 8 S. E. C. 853.

[4] *National Bank of the Commonwealth of New York City* v. *Mechanics National Bank*, 94 U. S. 437; *In re John Osborn's Sons & Co.*, 177 Fed. 184, C. C. A. 2d; *Johnson* v. *Norris*, *supra*.

* To be determined in event bondholders are allowed 6% interest.

Reasons for Granting the Writ.

1. The Circuit Court of Appeals has rendered a decision on important Federal questions of far-reaching significance and general application in the administration and distribution of assets under the Bankruptcy Act, in obvious and direct conflict with the established equity and bankruptcy practice.

The decision below presents a novel application of Sections 102, 106, 114, 115 and 200 of the Bankruptcy Act particularly with respect to the treatment of matured claims against solvent debtors under Chapter X.

The questions and principles involved are of a recurrent nature and are of particularly broad and general application at the present time in reorganization cases, vitally affecting literally thousands of public investors.

Due to war and postwar conditions or inflationary trends many debtors are now found possessed of assets sufficient to warrant interest upon claims before the return of assets or of the business to the debtor for the benefit of stockholders.*

Illustrative of the questions raised by this petition are two recent Chapter X proceedings in the Southern District of New York in which provision for interest on matured claims composed in part of unpaid interest to the date of the reorganization petition was contained in reorganization plans which have been approved. (*In re Childs Co.*, S. D. N. Y. Bankruptcy

* Directly raised is the same "apparent restriction on the power of the Bankruptcy Court . . . in the exercise of its broad equitable powers" which prompted this Court to review *Pepper v. Litton*, 308 U. S. 295, 296.

The present issues are of the same basic importance.

No. 82868, November 27, 1946, opinion by Conger, *D. J.*, CCH Bankruptcy L. Serv. par. 55779; *In re United States Realty & Improvement Co.*, S. D. N. Y. Bankruptcy No. 83280, order dated May 14, 1946, par. 18.)*

The recent decision of this Court in *Vanston* v. *Green*, 329 U. S. 156, 67 S. Ct. 237 (1946) does not determine the questions raised in this application. There, this Court dealt basically with the question as to whether interest was payable on interest coupons which accrued during the pendency of the Chapter X proceeding. In this case the questions relate to allowance of interest on claims in Chapter X which are composed in part of interest accrued prior to the proceeding. The need for clarification of the law in the present situation is equally as compelling as in the *Vanston* case.

2. The issues are of immediate importance because they concern the adaptation and application of established Federal equity practice by Chapter X reorganization courts which have heretofore been held to be "as much courts of equity as their statutory and chancellory antecedents".**

3. The decision below is radical departure from the commonly accepted principles in bankruptcy

* In several proceedings under Section 77 of Chapter 8 of the Bankruptcy Act, like issues may affect the rights of creditors. *In re Florida East Coast Railway Co.;* No. 4827-J S. D. Fla.; *In re Georgia, Florida and Alabama Railroad Co.;* No. 89 M. D. Ga.

** It is not claimed that a solvent debtor may not seek the protection of Chapter X, but it is urged that creditors are not thereby deprived of rights which would be accorded them in any other Federal court of equity.

and reorganization, and is based upon a conception of the purposes and effect of Chapter X which runs counter to equity, bankruptcy and reorganization precedents and practice. It calls for an exercise of this Court's supervision.

The court below has set forth an entirely new doctrine, or body of law, as to the character, incidents and "divisibility" of claims in Chapter X, the effect of which is to award holders of matured claims against solvent debtors a lesser amount of interest during the reorganization proceeding than they would be entitled to were the proceedings in bankruptcy or in equity.*

These matters are of such importance as to require critical analysis and determination at highest level, because it is the first instance in which the statutory definition of a claim under Chapter X (Section 106), its divisibility and incidents has been squarely raised.

4. The decision below results in anomalies, administrative complexities and numerous deviations from the present practice under Chapter X as it relates to the rights of creditors in reorganization proceedings—all being of paramount importance in the bankruptcy and corporate reorganization fields. Certain of the more significant aspects are covered in the annexed Brief with such brevity as the extent and intricacies of the issues and derivative problems permit.

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* Herein also exist the same "contrarity of tendancies in practical administration" which impelled supervision by this Court in *Case* v. *Los Angeles Lumber Products Co.*, 303 U. S. 106, 109.

The Federal questions are of the same, and no less, significance as those brought up for review by this Court in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 514 and *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, 92.

5. The Circuit Court of Appeals signally failed to follow the recognized state law, and its decision conflicts with applicable New York decisions, (a) in construing the Indenture of 1933 and (b) in other aspects of the case which the Circuit Court holds material to the issues and upon which it has placed much stress.

This decision is bound to prove misleading as to these important subjects not only for other tribunals but also for the State and Federal bar.

6. The prestige and respect enjoyed by the tribunal below and the volume of reorganization practice in the Second Circuit, *presently*, make certain the immediate spread of confusion in the practice there now obtaining—and, *prospectively*, is bound to lead to extensive conflict and divergent opinion with and between the other Circuits which have long followed the existent equity practice and will undoubtedly further disagree with the present ruling of the Second Circuit.

7. In simple justice, it is of transcendent importance that the wrong to this solvent debtor's many bondholders be rectified.

Importance of the Questions.

Certain of the more important aspects of the questions are patent from the questions stated at pages 10 and 11 hereof, while others are set forth in the Brief attached hereto and made part hereof.

Much attention has been drawn to the opinion of the Circuit Court of Appeals and a great deal of importance attached thereto by jurists and members of the Federal and Bankruptcy bars. The New York Law Journal, which does not publish the text of

Federal Court decisions except in rare cases of great importance, recently set forth on the front page the full text of the decision below. Your petitioner and its counsel have received a great many inquiries in respect thereto from attorneys, trustees, investors of all classes and others. The matter continues to be widely discussed and is of unquestioned public importance. Few decisions in recent years have been more broadly criticised or viewed as of such direct significance to distressed corporate creditors.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court directed to the Circuit Court of Appeals for the Second Circuit, commanding that said Circuit Court of Appeals certify and send to this Court a full and complete transcript of the record of all proceedings of said Circuit Court of Appeals had in said cause to the end that same may be reviewed and determined by this Court as provided by law, and that this Court grant such other relief in these premises as may seem just and proper.

Dated: October 18, 1947.

MANUFACTURERS TRUST COMPANY, as
Indenture Trustee under Indenture dated as of July 10, 1933,
By FRANK P. GAGE,
Trust Officer.

PERRY A. HULL,
Counsel for Petitioner

NEWMAN & BISCO,
Attorneys for Petitioner

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

Opinions of the Courts Below.

The opinion of the United States District Court for the Eastern District of New York (Moscowitz, *J.*) appears at page 171 of the record.

The prevailing opinion of the Circuit Court of Appeals for the Second Circuit (per Swan, *J.*) appears at page 211 of the record and the dissenting opinion (by Clark, *J.*) at page 218 of the record.

Jurisdiction.

Jurisdiction is invoked under Section 24, Subdivisions a and c, of the Bankruptcy Act (11 U. S. C. A. 47 a and c) and Section 240, Subdivision a, of the Judicial Code, as amended by Act of February 13, 1925 (28 U. S. C. A. 347a).

Statement of Facts.

The facts material to the consideration of the petition are set forth at pages 2 to 6 thereof.

The Statutes Involved.

The statutes involved are Sections 102, 106, 114, 115 and 200 of the Bankruptcy Act.

Questions.

The questions presented are set forth in the petition on pages 10 and 11 hereof and covered at length in this Brief.

POINT I.

The decision below raises questions not heretofore considered by this Court which are of great importance because of their widespread application in corporate reorganization practice and because establishing precedent in conflict with the long recognized authorities and the present equity practice.

A.

Whether the Congress intended to deprive creditors in Chapter X of any rights which they would have had in straight bankruptcy or in equity receivership—and whether a claim in Chapter X is something less than a claim in straight bankruptcy and equity—are questions of grave import.

Was the Circuit Court of Appeals free to disregard the present practice in such matters—or has it violated the provisions of the above quoted Sections 102, 114, 115 and 200 of Chapter X which this Court appears to have made applicable in such matters of distribution (*Vanston Bondholders Pro. Com.* v. *Green*, 329 U. S. 156, footnote 8 thereof).

B.

No court has ever questioned when a debt becomes due and great significance must attach to the doctrine newly announced below, that in Chapter X a debtor's debt will not be due at maturity "but that they will be extended in whole or in part by means of substituted obligations" (R 214). This can be the case, if at all, only where a plan duly accepted by creditors specifically provides for such substituted obligations. It cannot be true in a case where, as

here, no substitute obligation was ever proposed or consented to, for even non-assenting creditors are given "adequate protection" by Section 216 (7), and Judge Clark, dissenting, justly observed:

> ". . . creditors would have taken judgment at once; they should not be deprived of that advantage by the debtors *unassented-to act.*"

C.

The Circuit Court states, for general application, that in Chapter X

> ". . . debts do not become due finally except to the extent and in the manner that the plan provides." (R 214)

and this actually suspends the maturity of every debt and bases the further holding that Chapter X affords a solvent debtor a "moratorium", during which it need pay no interest [except as specifically required by the New York law of contract] upon any debts due at the time of its petition.

This is novel, radical doctrine indeed. On it the Circuit below utterly rejects in Chapter X the so-called "judgment theory", a principle of long standing in Federal equity jurisprudence and first applied in bankruptcy by the same Circuit (*National Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank*, 94 U. S. 437; *In re John Osborn's Sons & Co.*, 177 Fed. 184).

D.

Under all recognized authorities and for all practical purposes, the overdue interest merged with the overdue principal into a single indivisible claim on

October 1, 1943. (*Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510; *National Bank of Commonwealth of New York City* v. *Mechanics National Bank, supra; Adams* v. *Napa Catine Wineries*, 94 F. (2) 694; *United States* v. *Peerless W. V. M. Corp.*, 96 F. (2) 996, certiorari denied.) *Ferguson* v. *Lyle* (267 Fed. 817, 819, C. C. A. 5th) holds

> ". . . creditors are entitled to interest owing at the time of the filing of the petition. The case is therefore reversed . . . with directions to allow the whole of the claim of appellants. . . ."

No justification exists for (1) splitting a "claim" as to principal and interest and then (2) treating each portion separately in determining allowance of interest, as was done in this case (R 217).

If a debtor has several creditors, to some of whom only interest is due at the time of the petition, would the claims for such interest be singled out and distinguished from all other claims as not equitably entitled to interest? That is the effect of the ruling below (R 180, fol. 539-540).

Most corporate debtors have large interest obligations maturing about the time of their petitions, and the rule stated below upsets the present practice in these matters in almost every case.

The present practice has not varied over the years while the allowance of interest, assets permitting, is a matter of common occurrence. Yet to this date no limitation has been placed upon the definition of "claim" in Section 106 of Chapter X. The practice herein provided deserves proper elucidation of important principles for general application, for example: is interest due at the time of the petition a "claim" under Chapter X?—if so, is such claim

separate and distinct from a claim for principal maturing on the same date under the same contract?—and what is comprised in the base of an allowed "claim" upon which interest may be computed?

In straight bankruptcy, under Section 63, a matured "claim" for principal and accrued interest would not be divisible for any purpose, *i. e.*, for allowance of interest, voting, etc.

E.

No Circuit Court has heretofore rejected the judgment theory and the Circuit below has seen fit to explain

> ". . . we are not convinced that the 'judgment theory' is applicable in a Chapter X reorganization, where the very purpose of the proceeding is to keep the debts in *statu quo* until a plan can be adopted under which the debtor may continue in business without having its property burdened with judgments" (R 214).

The fact is, the judgment theory establishes and stabilizes the character, amount and incidents of each obligation of a debtor as of a given date and so maintains the "*statu quo*",[1] and the dissenting Judge properly correctly stated:

> "As the opinion substantially concedes, allowance of a claim in bankruptcy fixes it, just as does a judgment. . . ."

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[1] *Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank, supra; In re John Osborn's Sons & Co., supra.*

Furthermore, the judgment theory can no more "burden the property of the debtor" than can the equity rule for interest where assets permit.[2]

More occasion actually appears for invoking the judgment theory in Chapter X [whenever the question is directly raised on behalf of creditors, as here, and not waived by plan] in which the whole going business is returned to the ~~creditor~~ debtor and stockholders, both of whom are thereby benefited, than there would be in cases of bankruptcy, equity or statutory liquidation proceedings in which the business and all assets are eventually liquidated and utterly lost, to the detriment of the debtor and the stockholders.

The Circuit Court has used broad sweeping language which, if allowed to stand, is certain to lead to much confusion for it upsets the long established practice in Federal and State equity courts where interest is allowed on the whole debt, assets being sufficient.[3] Its specious reasoning should be reviewed and disclaimed.

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[2] *Johnson* v. *Norris*, 190 Fed. 459, C. C. A. 5.

[3] *In re Childs Co.*, S. D. N. Y. #82868, Nov. 27, 1946, opinion by Conger, *D. J.*, C. C. H. Bankruptcy, Bk. Cy. L. Serv. Par. 55779; S. E. C. Corp. Reorg. Release #67 and #69, C. C. H. Bankruptcy Bk. Cy. L. Serv. Par. 55734 and 55778; *In re United States Realty & Improvement Co.*, S. D. N. Y. #83280, order dated May 14, 1946; *In re Town*, Fed. Case #14112, E. D. Mich. 1873; *In re Bank of North Carolina*, Fed. Case #895 W. D. N. C. 1875; *In re Hagan*, Fed. Case #5898, S. D. N. Y. 1873; *Richmond* v. *Irons*, 121 U. S. 27; *People* v. *Merchants Trust Co.*, 187 N. Y. 293, 297-9; *People ex rel. Immigrant Industrial Savings Bank*, 284 N. Y. 57, 1940; *People* v. *American Loan & Trust Co.*, 172 N. Y. 371; *Lippitt* v. *Thames Loan & Trust Co.*, 88 Conn. 185, 206-7; *Central Bank & Trust Co.* v. *State of Ga.*, 139 Ga. 54, 56, 58; *Elliot* v. *First National Bank of Pendleton*, 32 F. Supp. 839; *Stein* v. *Delano*, 35 F. Supp. 260, affd. 121 F. (2d) 975 (C. C. A. 3rd). See also 3 *Michie Banks and Banking*.

F.

In particular this is the only time a Circuit Court has failed to apply, where the facts are squarely analogous, the long established equity principles for allowance of interest laid down in *Johnson* v. *Norris, supra,* recently again cited with approval by this Court.

G.

The Circuit Court of Appeals in effect holds that the claim on the simple debt for interest, which did not carry contract interest, must be denied interest in Chapter X. It makes that purpose unequivocally clear when it distinguishes its own prior ruling (*In re John Osborn's Sons & Co., supra*) on the ground that "in that case the bankrupt made no contract providing for payment of interest", showing it would deny interest on the claim for accrued interest as well as on the claim for principal.

Does Chapter X grant a "moratorium" during which a debtor can escape all interest except that provided by contract held to be valid under the State law?

The rule laid down below offers opportunity and invitation to unscrupulous debtors to engage in abortive reorganization proceedings under Chapter X for the purpose of avoiding, throughout the proceeding, all interest on matured and defaulted debts, except that previously stipulated by contract; it would encourage debtors to prolong such proceedings for like purpose; it proposes that any creditors holding debtor's promise for interest after maturity would be bettered and privileged over other creditors

to the extent of such interest; it creates a practice prejudicial and unjust to creditors and is bound to lead to widespread abuse; and it is demoralizing to both debtor and creditor alike.

It is of transcendent importance that this unconscionable practice be stopped before it assumes alarming proportions.*

H.

It is of great moment that a court of equity has sanctioned profit by a solvent debtor at the expense of creditors powerless to resist a proceeding where a large part of the sums due at the time of the petition (over $1,280,000) were withheld without any interest whatever though profitably used in enriching debtor's estate.

This does violence to all of the principles long recognized in the Federal and State authorities above cited, *Johnson* v. *Norris, supra,* being exact in point of fact and apposite in point of equitable rationale and doctrine. *Sexton* v. *Dreyfus* (219 U. S. 339, 346) holds

> "There is no more reason for allowing the bankrupt estate to profit by the delay beyond the date

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* Specifically, debtor defaulted at maturity as well as in timely payment of the contract rate of interest claimed by debtor to be due on principal after maturity. Having received the vast income and profits from such moneys throughout the proceedings, it belatedly tendered with the debt only contract interest on principal when refunding through its stockholder 18 months later.

In the absence of contract for interest after maturity, stockholders would have succeeded to all and entire the income from moneys which were detained from bondholders during the statutory stay in Chapter X.

Can such practice spring from Chapter X?

of settlement than there is for letting creditors do so."

That rule and other equitable rules as to distribution of assets and allowance of interest by Federal Courts and in bankruptcy is made applicable herein by Section 115, which Section has been held by this Court to be applicable in such matters (*Vanston Bondholders Pro. Com.* v. *Green, supra*).

That creditors of any class should suffer for the benefit of a solvent debtor and its stockholders in a court of equity is unthinkable.

I.

Present practice[4] is further disturbed by the fact that the Circuit Court of Appeals, in determining both the practice as to allowance and rate of interest, has applied authorities pertaining to Federal distribution of assets in cases of insolvency—*where the balance of equities is between creditor and creditor.* The dissenting opinion makes clear that the authorities relied upon in the prevailing opinion are inapposite, stating:

> "This is now a contest between a solvent debtor and its creditors . . . The cases in railroad reorganization are cases involving the equities between classes of creditors" (R 218, 219).

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[4] Per authorities in footnotes 1, 2 and 3 above.

J.*

Any unsuccessful motion to dismiss a debtor's petition for lack of "good faith" is entirely foreign to the equitable allowance of interest unless, conceivably, shown to prejudice debtor, *a circumstance not here presented*. Even the debtor did not argue or claim prejudice or that the motion to dismiss for lack of good faith in any way affected bondholders' right to interest. Nevertheless, the ruling below establishes a dangerous precedent in that respect (R 215-217) for the Circuit Court of Appeals then goes on to hold it "most inequitable for creditors who so long acquiesced in the pendency of the proceeding, now to say that all the time it was nothing but a bad faith moratorium to keep them out of their money" (R 217).

The motion as to "good faith" of the petition did not in any manner delay the proceedings and thereafter creditors had no alternative but to "acquiesce". Even had they appealed, as the Circuit below suggests, would they still be deprived of interest simply because they were powerless to dismiss a statutory proceeding? See *Johnson* v. *Norris*, *supra*, as quoted in Point II hereof.

The decision effectually places Danceles' sword over the head of *all* creditors in event any one of their num-

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* It is a matter of most serious consequence that the Circuit Court of Appeals so far misapprehended the issues, as to state that "bondholders contend the petition was not filed in good faith" and to thus misrepresent bondholders' position in the present issue as a motion to dismiss made by an insignificant portion of bondholders—less than 1/5 of 1% in amount.

The facts surrounding the petition (such as debtor's solvency, its failure to make timely provisions for payment of bond at maturity, etc.) were pointed out as factors to be weighed in balancing the equities between a solvent debtor and its creditors (*Johnson* v. *Norris*, *supra*) but those factors were entirely misapprehended and disregarded.

The good faith of the petition, as such, is not here at issue and is not challenged. The interest questions were reserved at the debtor's instance, and no such issue was even raised by it.

ber unsuccessfully moves to dismiss a petition for lack of good faith. It discourages resort to that statutory right of every creditor in Chapter X.

Evils bound to result from the ruling herein are difficult to estimate and the iniquitous over-all results are sure to approach sociological as well as juridical proportions.

K.

The "bargain" conceived of below does not even exist under New York law (see Point III) and this basic error will stand as a misleading precedent to all lower courts and other or distant Circuits. Review is specially urged to obviate further misconception of and divergence from, the local law (R 217).

Even if the "bargain" be valid under state law, does that mean the reorganization court is bound thereby in allowing interest under its broad equitable powers? In other words, what are the factors that must be weighed in balancing the equities between a debtor and its creditors? See heading "L" of this Point.*

L.

This is the first case to hold that a "bargain" [a pre-existent contract limiting the rate at which and the base upon which interest is to be computed on principal after maturity], because held to be valid under the State law, has been held to outweigh and override all other equities between a solvent debtor and its creditors. In reaching that conclusion the Circuit Court stated (R 215-217):

> "Conceivably Chapter X may permit a debtor to hold off its creditors, even though it has sufficient assets to pay them, merely because its business

* The Court below saw fit to work errors (J and K) into one argument, but this cannot confuse the very apparent issues.

> will suffer disproportionately if it is compelled to make such sacrifice (See *In re Loeb Apartments*, 89 F. (2) 461, C. C. A. 7)."[5]

It is not questioned that a solvent debtor may petition in Chapter X—but this petitioner maintains that creditors are not thereby deprived of rights which would be accorded them in any other Federal court of equity or bankruptcy.

M.

Not heretofore determined by this Court are two questions of outstanding importance in the Federal administration of assets, viz. Where the balance of equities is between creditors and debtor, is the allowance of interest on a claim which matured at the time of the petition in any manner dependent upon or limited or controlled (a) by the State law, or (b) by the terms of a contract, held to be valid under State law, as to the payment of interest after maturity, but which for 18 months thereafter stood breached in all respects?

The significance of these two questions in their application to the case at bar and other cases becomes apparent from the declared principles of this Court[6] that, assuming *arguendo* a contract to pay interest on coupons is valid under State law, such contract is nevertheless subordinate to the paramount question of whether the allowance of such interest, under the circumstances of the case, "would be compatible with

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[5] That case was also inapposite because "more than 66⅔% of the creditors had consented to the adoption of the plan . . . offered not by debtor but by creditors".

[6] *Vanston Bondholders Pro. Com.* v. *Green*, *supra*.

the policy of the Bankruptcy Act" to do equity between creditors and creditors of different classes.[7]

Let us, therefore, assume *arguendo* an agreement valid under State law to pay less than the legal rate of interest only on principal after maturity. **Will such agreement be subordinated to the paramount question of whether, in the circumstances of this case, the allowance of only such lesser interest would be "compatible with the policy of the Bankruptcy Act" to do equity between the solvent debtor and its creditors?**

Petitioner urges (1) that the Federal Court *alone* has jurisdiction and power to say "how and in what cases interest shall be allowed under equitable principals" and (2) that a solvent debtor should be equitably estopped or barred [except where it shows prejudice resulting from some act of the creditor] from asserting an agreement, held to be valid under State law, so as to deny creditors right to the legal rate of interest on the face amount of any claim due at the time of the petition during the period that the moneys withheld from them by statutory stay were being profitably used in debtor's estate. (*Dietrich* v. *Greaney*, 309 U. S. 190, 196; *Johnson* v. *Norris, supra.*)

* * * *

The issues pointed out above, and those apparent from the questions stated above, are of such importance and practical widespread application in the corporate reorganization field as to warrant review by this Court.

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[7] This Court, for the same reasons, similarly subordinated a contract, valid under State law, for interest upon coupons although the security therefore was admittedly adequate and notwithstanding the fact that the underlying mortgage was superior to all other liens and as such was not involved in the reorganization proceedings wherein the distributions of interest were to be made. *Fleming* v. *Traphagen, et al.*, 64 Sup. Ct. Rep. 365.

POINT II.

The decision below is in basic conflict with the long recognized principles of equitable jurisprudence as enunciated by this Court and by the several Circuit Courts of Appeal in matters affecting the Federal administration of property in *custodia legis*.

Much of the conflict between the decision below and the other tribunals appears from Point I above, and our purpose herein is to briefly point up important aspects of these numerous conflicts in the light of the problem at bar and related issues which seem certain to arise in the wake of the decision below.

As to the Conflict with the Fifth Circuit.

In *Johnson* v. *Norris*, 190 Fed. 459 (1911), the Fifth Circuit in a learned treatise, long recognized as authority, allowed interest on claims in bankruptcy, which claims included "interest to the date of filing the petition" (p. 461). The problem there considered exactly parallels the present one in all material, determinant respects,* to wit:

> "Can it be that the Act means that a voluntary petitioner may, although solvent in fact, stop the interest on his debts, while collecting by the trustee the interest on his assets; . . . in an *ex parte*

* Having in the main interest bearing and income producing assets, the solvent debtor herein, during the 18 months of this proceeding received and retained the vast earnings not only from the $5,710,400 unpaid face amount of the bonds (on which it seeks to pay but 5% interest) but also the very great income upon the $1,286,646.43 lump-sum accumulations of interest on which it seeks to pay no interest whatever.

proceeding which his creditors are not heard to resist?

In such case, if the contention of the respondents is to prevail, the proceedings may be greatly to the profit of the bankrupt after paying the referee and trustees the fees allowed by law.

The extraordinary result would be that a delay in payment arising from a proceeding begun by the debtor, and which the creditors were powerless to resist, would prevent the creditors from collecting interest out of an estate able to pay it, when the general rule is that interest is always given for delay in payment.

The bankrupt's estate often, as in this case, may consist, in the main, of interest bearing assets.

Where the settlement is delayed, this interest may amount to a large sum.

A construction of the act that would give it to the bankrupt, and leave unpaid interest on debts due from the bankrupt would seem strangely inequitable. . . . the litigation was begun by the debtor, and no proceeding was had at the instance of others to delay payment.

When the bankrupts . . . move the court to direct the fund to be paid to them, they should be required to do equity by paying the interest due by law up to date" (p. 463).

That case differs from the case at bar only in the respect that it was a proceeding in Bankruptcy. Under Sections 114 and 200, the jurisdiction, powers and duties of the Court as well as the rights, duties

and liabilities of creditors and of all other persons in respect to the property of the debtor would be the same in Chapter X, unless inconsistent therewith. The *Vanston* case (*supra*) indicates that such inconsistency does not exist. See footnote 8 of the Opinion of the Court therein.

Further conflict with the Fifth Circuit, as to the status of interest as an essential component of the base of a "claim", is to be found in the decision in *Ferguson* v. *Lyle*, 267 Fed. 817, 819 (1920) hereinabove quoted in Point I.

As to Conflict with the Third Circuit.

In *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (1917) the Third Circuit, interpreting creditors' statutory rights under the Bankruptcy Act, set forth the principles controlling in Federal statutory administration as follows:

> "In enforcing creditors' rights in the new way, it appears to us that equity should protect them in the same measure and preserve to them the same advantages, so far as practicable, that the law gave them before bankruptcy stepped in and interfered with them . . .
>
> As we are dealing in this case with the equitable administration of bankrupt assets, *where creditors' legal rights are preserved but where their legal remedies are lost* and equitable remedies are substituted, equity requires that the new remedies be as effective as the old in protecting and enforcing such rights." (Italics supplied.)

Here, the Circuit below has propounded entirely new doctrine whereunder the "new remedies" afforded by the statute are not as effective as the old in protecting and enforcing creditors' rights. It is in such radical conflict with the above quoted principles as to actually deprive creditors of the lawful right of suing upon their claims without, however, substituting any "effective" equitable equivalent.

Also, the Third Circuit, in a statutory liquidation in *Stein* v. *Delano,* 35 F. Supp. 260, affd. 121 F. (2) 975, cert. den. 314 U. S. 655, held:

> "The value of each claim at the time of the declaration of insolvency is the principal sum due . . ."

and the Circuit Court of Appeals in affirming said judgment stated:

> "The New Jersey National Bank and Trust Company did not profit to any ascertainable amount by becoming insolvent and failed to pay its debtors. It is being assessed interest *for the damage it did its creditors* rather than for any profit it obtained from the failure to honor its debts."

and the conflict with that principle is made obvious by the fact that here a very sizable profit (R 144) accrued to the debtor by reason of the fact that impressive sums due to creditors at the date of the petition were profitably kept in its business during the proceeding.

As to Conflict with Decisions of This Court.

A. As to the Allowance of Interest on Equitable Principles.

This Court stated in *Vanston Bondholders Pro. Com.* v. *Green* (329 U. S. 156), which also cited with approval *Johnson* v. *Norris*, as follows:

> "But where an estate is ample to pay all creditors and pay interest even after the petition was filed equitable considerations were invoked to permit this additional interest to go to the secured creditor rather than to the debtor.
>
> "It is manifest that the touchstone on each decision on the allowance of interest in bankruptcy and receivership has been a balance of equities between creditor and creditor or creditor and debtor."
>
> ". . . In either event first mortgage bondholders would have been enriched and subordinate creditors would have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a Court order for the benefit of debtor, creditor and the public. Such a result is not consistent with equitable principles . . .".

Emphasis is thereby placed upon the contrary and conflicting rule herein below announced, wherein a solvent creditor is allowed to escape the payment of any interest except as required by pre-existent agreement. If, therefore, in the words of this Court we

interpolate the facts of the case at bar it would result in substantially the following:

> **"Where an estate is ample to pay all creditors and pay interest . . . the ~~creditor~~ debtor has been enriched and bondholders have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a Court order which is as much if not more for the benefit of the debtor and the stockholder in preserving their equities as for creditors and the public".**

B. As to the Conflict with the Very Apparent Intent of the Statute.

This Court in the *Vanston* case, *supra,* indicated that such Section 115 of Chapter X is applicable in a matter involving the balancing of equities between creditor and creditor.

For what appears as a very inadequate reason, the Court below in effect holds to the contrary. The only apparent reason for its conclusion seems to rest in the fact that the Chapter X stay aided creditors as much as debtor—in other words that there exists an exception in this case where equities are balanced between the debtor and its creditors.*

This raises the question whether Sections 114, 115 and 200 of Chapter X have been violated by the decision below.

It would seem adequately clear that even under ancient authority (*Sexton* v. *Dreyfus,* 219 U. S. 339; *Bromley* v. *Goodere,* 1. Atkyns, 75), and under either

* If any such very important conflict or inconsistency does exist, it deserves immediate clarification by this Court on terms which will rationally and justly reconcile same with the existent law and practice.

the judgment theory or on equitable principles, the fact that the equities are to be balanced between a creditor and its debtor does not give rise to a situation so inconsistent with any purpose or provision of Chapter X as to read an exception into said Sections. Hence, the decision herein is patent conflict with the apparent reasonable Congressional intent underlying said sections.

Further, the definition of "claims" in Chapter X, Section 106(1) does not recognize any difference in the source of a "claim" or any basis for dividing an obligation arising out of a single contract for payment on a given date. The treatment accorded the claim below therefore is also a direct conflict with Sections 102 and 106(1) of Chapter X.

As to Conflict with the Judgment Theory.

On the same broad equitable principles, but with more significant clarification, this Court allowed interest upon claims for interest in the liquidation of a national bank on the grounds that in equity a claim has the same efficacy and occupies the same legal ground as a judgment. The rationale of *National Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank* (94 U. S. 437) is particularly applicable in the present discussion. There interest was allowed [1] upon interest which had accrued between September 24, 1873, and November 22, 1873, on which latter date the receivership started, as well as [2] upon interest accruing from said latter date to November 20, 1874, when the last installment of principal was paid, this Court stating:

> "Two errors were assigned: (1) That the plaintiff below was not entitled to recover any interest.

(2) If interest was recoverable, as demanded, the plaintiff was not entitled to *interest on the gross amount of such interest* from the time when the last installments of the principal were paid . . .*

If these claims had been put in judgment . . . the result as to interest upon the judgment would have been the same . . . After they were proved, they were of the same efficacy as judgments, and occupied the legal ground . . . They are within the equity, if not the letter of these statutes, and bear interest as judgments.

The interest lawfully accruing upon each of the claims was as much a part of it as the original debt. The creditor had the same right to the payment of the one as the other . . .

If . . . the suit had been for the balance, consisting of interest only, the same result would have followed . . .

The plaintiff . . . is entitled *ex aequo et bono*, to the money sought to be recovered. Where the right to recover exists in this class of cases, it includes interest as well as principal, unless there is something which would render the payment of the former inequitable . . .

. . . See also *Robinson* v. *Bland*, 2 Burr. 1087. In the latter case Lord Mansfield said: 'The interest is an accessory to the principal and the plaintiff cannot bring a new action for any interest grown due between the commencement of his action and the judgment in it . . . I don't know of any court in any country . . . which does not carry interest down to the last act by which the sum is liquidated.' "

* Italics supplied.

The doctrine thus enunciated has been widely accepted and adopted in equity jurisprudence[1] and even the Circuit Court of Appeals below adapted and applied the same principles to claims under the Bankruptcy Act in *Re John Osborn's Sons* (177 F. 184, C. C. A. 2d) as follows:

> "We think that allowed claims in bankruptcy are as such entitled to be treated as judgments . . .
>
> Following the case of *National Bank of the Commonwealth of New York City* v. *Mechanics National Bank, supra,* the order is affirmed."

The New York Court of Appeals has recognized the status of allowed bankruptcy claims as "judgments" (*American Woolen Co.* v. *Samuelsohn,* 226 N. Y. 61, 70) and the courts of that state have enunciated similar principles (*Dorland* v. *Fidelity Deposit Corp.,* 104 Misc. 97; *Hunting* v. *Blun,* 143 N. Y. 511; *Lang* v. *Lutz,* 180 N. Y. 254, 260; *People* v. *Merchants Trust Co.,* 187 N. Y. 293; *Skilton* v. *Codington,* 185 N. Y. 80, 87).

As to Conflict with This and with Other Federal and State Courts in Respect to the Basic Principles That, Where Assets Permit, Equitable Considerations Are Always Invoked for the Payment of Interest upon Claims at the Legal Rate from the Date That Equity Intervened.

The very reasons given by the Circuit Court of Appeals for rejecting the judgment theory and so disallowing interest—viz: an act of law, or moratorium, designed for conservation of assets as much

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[1] See: 3 *Michie Banks and Banking,* Perm. Ed. 499; *Stein* v. *Delano,* 35 F. Supp. 260, D. N. J. 1940, aff'd. 121 F. 2nd 975, C. C. A. 3rd, 1941, cert. den. 314 U. S. 655, 1941; *Elliott* v. *First Inland National Bank* v. *Pendelton,* 32 F. Supp. 839, D. Oreg. 1940; *State ex rel. McConnell* v. *Park Bank & Trust Co.,* 151 Tenn. 195, 208; *People* v. *Farmers State Bank,* 371 Ill. 222, 224, 1938.

for the protection of creditors as of the debtor—have been carefully weighed and discarded by practically all of the authorities.

In the *Vanston* case, *supra*, as in practically all of the earlier Federal and State authorities,[2] it has been pointed out that

> "Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interest involved."

Nevertheless, in all of the other authorities, as in said case, the conclusion is reached, on one ground or another, that

> "Where an estate is ample to pay all creditors and pay interest even after the petition was filed, equitable considerations were invoked to permit the payment of this additional interest . . ."

The decision below offers no new reasons, *i. e.*, none that have not already been considered by the authorities, for making a distinction in Chapter X proceedings, and is, therefore, in basic conflict with all such authorities.

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[2] *Johnson* v. *Norris*, 190 Fed. 459 (C. C. A. 5th); *In re John Osborn's Son*, 177 Fed. 184 (C. C. A. 2); *National Bank of the Commonwealth of the City of New York* v. *The Mechanics National Bank*, 94 U. S. 437; *Sexton* v. *Dreyfus*, 219 U. S. 339; *People* v. *Merchants Trust*, 178 N. Y. 293; *People* v. *American Loan & Trust*, 172 N. Y. 371; *Ohio Savings Trust Co.* v. *Willys Corp.*, 8 Fed. 2. 463 C. C. A. (2d); *Richmond* v. *Irons*, 121 U. S. 27.

In *American Iron & Steel Manufacturing Co.* v. *Seaboard Air Line Railroad* (233 U. S. 261), it is stated:

> "Even in bankruptcy, *and in the face of the argument that the debtor's liability on the debt and its incidents terminated at the date of adjudication*, and as fixed liability was transferred to the fund, it has been held, in the rare instances where the assets ultimately proved sufficient for the purpose, that creditors were entitled to the interest accruing after adjudication."

While it is not here questioned that a solvent debtor "may seek relief under Chapter X simply because its business will suffer disproportionately if it is compelled to make the sacrifice" (R 216)—this does not necessarily imply that creditors are to sacrifice interest in order to enable a solvent debtor to avoid sacrifice on its part.

To permit the debtor an opportunity to avoid sacrifices which its stockholders would otherwise suffer, should in equity warrant compensation to those who are actually harmed thereby.*

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* If a claim be one upon which judgment could not have been obtained had there been no stay in Chapter X, there would be no occasion to accord the creditor judgment rights or legal interest on his claim.

If a claim does not mature during the proceeding, the creditor is relegated to the contract rate, throughout the proceeding.

If the claim matures at or about the filing of the petition, the equitable principles of long standing require interest from maturity, the contract rate prevailing prior thereto. By "maturity" is meant normal maturity, not accelerated maturity.

This makes clear that we do not urge that judgment interest be allowed as a penalty for the institution of the Chapter X proceedings, as the decision below might lead one to believe (R 215-217).

The Court below, itself, long ago in *Ohio Savings Bank and Trust Company* v. *Willys Corporation*, 8 F. (2) 463 (1925), recognized that in equity:

> "It is true, however, that as a general rule, after property of an insolvent is in *custodia legis*, interest thereafter accruing is not allowed on debts . . . The reason assigned is that in such cases the delay in distribution is held to be the act of the law and a necessary incident to the settlement of the estate. . . . The rule does not prevent the running of interest during a receivership, and if, as a result of good fortune or good management, the estate proves sufficient to discharge the claims in full, interest as well as principal is to be paid . . ."

This Court in *Royal Indemnity Co.* v. *United States*, 313 U. S. 289, dealt with the historical background for the allowance of interest "for non-payment of the amount found to be due" and, though the case was a suit at law, this Court considered the fault for the delay the fair measure of damages involved, stating:

> ". . . Here responsibility for delay in payment rests quite as much upon the debtor, who is chargeable with knowledge of its own obligation and the breach of it, as upon the creditor. And *in the meantime, the debtor has had the use of the money, of which its default has deprived the creditor*. . . . Interest upon the principal sum from the date of default, at a fair rate, is therefore an appropriate measure of damage for the delay in payment . . ."

Again in *Richmond* v. *Irons*, 112 U. S. 27, in a liquidation proceeding involving book accounts of depositors which included interest, the Court said:

> ". . . In the case of book accounts in favor of deposits, which was the nature of the claims in this case interest would begin to accrue as against the bank from the date of its suspension. . . . and it follows that interest should be computed upon the amounts then due as against the shareholders to the time of payment."

In direct conflict with all known authority, the judgment below establishes the principle that the *solvency is not an equity to be "balanced" in determining whether interest is to be allowed upon the allowed claims of a debtor.* In this case the ruling has the further effect of turning the back of the Chancellor upon the fact that the debtor could have liquidated sufficient assets to pay its debts rather than to resort to an abortive Chapter X proceeding. This means that, in all cases of solvent debtors possessed of assets seemingly sufficient to meet its obligations at the time of the Chapter X petition, that fact could not be weighed in balancing the equities between such debtor and its creditors. It is an inequitable doctrine of far-reaching import in all reorganizations. It is a temptation to any debtors inclined to inequitable means for thwarting the legitimate ends of unoffending creditors. The basic conflict is patent.

* * * *

The aforementioned conflicts with all other authority are such as to call for the exercise of this Court's power of review in these premises.

POINT III.

The Circuit Court has decided important questions of local law in a way obviously conflicting with the settled law of New York.

a.

The Supplemental Indenture of 1933 materially modified the terms of the prior indentures. It added to debtors promised to pay at maturity the words "duly" and "punctually" (contract R 42 with R 92 and 99). It also added the provision granting individual bondholders the right of suit upon default in such payment (R 122, fol. 366). The provision that collections by the Indenture Trustee, under its conditional remedies, should be applied with interest at 5% on past due principal was a carry over from the 6% rate in the prior indentures (contract R 49 and 120).

Under the local law the new additions and agreements were controlling and took precedence over any prior engagements of the parties.[1] The Court below has violated this basic principle.

b.

The undisguised effect of the judgment below is to except, and read out of the indenture, the words "duly" and "punctually" as added in 1933—it affords no meaning to those words whatever (R 213). Such

[1] New York has always recognized that new or different words or provisions when added or used in modification of a prior contract, are controlling over the words and provisions of such contract. *Wynkoop H. C. Co.* v. *Western Union Tel. Co.*, 268 N. Y. 108; *Scruggs* v. *Cotterill*, 67 App. Div. 583; *Hart* v. *Lauman*, 29 Barb. 410, 416. See also opinion of the District Court (R 174-175).

an interpretation and construction is not permitted under the local law. It diametrically opposes the New York rule.[2]

c.

The Circuit Court based its determination of bondholders' contract rights on inapplicable authorities wherein the contract rate of interest was payable "until principal shall be paid" or "to the date of payment of the amount", however long that might be after the due date (212).[3]

The cases relied upon by the Court below have been carefully limited by the New York decisions to contracts involving the precise terms quoted or those clearly indicating similar intent.

The principles of those cases have not been extended beyond the particular covenants there involved—not one of them involve a contract involving the words "due", "duly" or "punctually".

In New York, both *Taylor* v. *Wing* and *O'Brien* v. *Young*, have been distinguished and declared inapposite in construing an agreement like the present indenture, where the specific and particularizing words "duly" and "punctually" may not be excepted, but must be deemed to denote a promise of punctual pay-

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[2] "A contract containing a term inconsistent with a term of an earlier contract between the parties is interpreted as including an agreement to rescind the inconsistent term in the earlier contract." (2 Restatement of the Law of Contract, Sec. 408.) See also opinion of the District Court (R 175, fol. 524).

[3] *Taylor* v. *Wing*, 84 N. Y. 471; *O'Brien* v. *Young*, 96 N. Y. 428; *Agency of Canadian Car. & F. Co.* v. *American Can Co.*, 258 F. 363, which the District Court had properly analyzed and distinguished (R 174-175).

ment on the due date, for as stated in *Ferris, et al.* v. *Hard,* 135 N. Y. 354,

> "This is not like the agreement to pay interest . . . until the principal sum is paid, such as the case of *Taylor* v. *Wing* . . . the whole principal sum of ten thousand dollars was to be at an interest of seven per cent . . . *until due* . . . If . . . not paid *when due,* the contract was violated, and interest after that . . . could only be recovered as damages and at the rate of interest authorized by law (*Bennett* v. *Bates,* 94 N. Y. 354; *O'Brien* v. *Young,* 95 id. 428)."*

d.

The decision below reads right out of the indenture, Article VI, Section 8 which grants individual bondholders the right of suit at maturity, a right theretofore reserved only to the Trustee. This new right was not in any sense "inconsistent" with the rights of the Trustee. It does not "cripple" the Trustee nor does it prevent the Trustee from adequately asserting bondholders' claims. To so construe the indenture, not only deprives them of this new and all important additional right or innovation, as added for their sole benefit in 1933, but violates the long-recognized New York rule that any newly added specific material is bound to control. Cardozo, *J.*, speaking for the New York Court of Appeals in *Lieberman* v. *Templar Motor Co.,* 236 N. Y. 139 (1923), stated the rule very clearly:

> "Those who make a contract may unmake it or substitute another either wholly or partly inconsistent. The invalidity of the substituted contract must be determined, like that of any other,

* Italics our own.

> in the light of the situation existing at the hour of its making. If valid then, it will supercede or modify the first to the extent that the two are unable to stand together."

e.

It is settled in New York that any ambiguity or inconsistency in an indenture must be construed against the debtor which prepared the instrument and sold bonds on the basis thereof. Inconsistencies, if any, must be resolved in favor of bondholders purchasing such bonds.[4]

The Court below violated that basic rule by construing what it terms an "inconsistency" against the bondholders (R 213). It thus reads out and nullifies the provisions and evident purpose of Articles III and IV as to due and punctual payment at maturity, as well as Article VI, Section 8, giving bondholders the unconditional right to sue at maturity and instead thereof has given effect to the provisions of Article VI, Section 4, which provide that monies collected by the Trustee, in the exercise of its conditional remedies, shall be paid with interest at the contract rate only on the overdue principal. It holds that any other interpretation would induce an "inconsistency", viz:

> "It would introduce an inconsistency . . . it would result in making it necessary for all bondholders to sue personally, or in a class action, in order to recover the full amount of their claims, and would prevent the Trustee from adequately

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[4] *Prudence Co.* v. *Central Hanover Bank & Trust Co.*, 262 N. Y. 311 affd. 262 N. Y. Supp. 311; *Barnes* v. *U. S. Steel Corp.*, 11 N. Y. Supp. 2d 161; *Cunningham* v. *Pressed Steel Car*, 238 App. Div. 624, 262 (1933) affd. 263 N. Y. 671 (1934); *Enoch* v. *Branden*, 249 N. Y. 263, 268 (1928). See also opinion of District Court herein (R 176, fol. 526).

asserting their rights. Certainly, the Trustee is not to be so crippled; . . ." (R 213).

Further on in the opinion, it denied all other interest on bondholders allowed claim in Chapter X, stating:

> "We find no equities to override the *bargain* which the parties made for themselves, namely, that overdue principal should bear interest at the rate of 5%," (R 217).

But such "bargain" does not exist when the indenture is construed under New York law as we shall see.

In the first place, the ruling below offends the New York law because it effectually wipes out the all important 1933 innovations, for as stated in *Lang* v. *Lutz* (180 N. Y. 254, 259):

> "It was a valuable right, resting on contract and he could not constitutionally be deprived of its full enjoyment. It constituted a part of his security for any debt contracted by the Company."

and in this case the innovation constituted bondholders' sole assurance that at maturity they might immediately reduce any debt to judgment—to the exclusion of any right exercisable by the Trustee in their behalf.*

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* The original indentures vested all rights of action in the Trustee. The 1933 modification restored to bondholders their common law right of suit on the due date. The Circuit Court entirely disregarded this modification and so deprived bondholders of the newly granted right to full freedom of individual action at maturity—a constitutional contract right under New York law. It further contravened local law by depriving bondholders of their constitutional right to have their contractual intent interpreted, and their rights under the contract determined, under applicable New York law.

In the second place, the ruling below actually introduces the very anomalies which the District Court had foreseen and depicted as bound to arise under any interpretation hostile to bondholders under State Law (R 175-176).

Thirdly, under New York law those anomalies are preponderant and of determinant significance in comparison with the "inconsistency" claimed to have been avoided by the Circuit Court, if same ever existed.[5]

Fourthly, under New York law, the 1933 innovation cannot cripple the Trustee nor prevent it from adequately asserting their rights, by any stretch of the imagination.

Construction under local law would assure the preservation and exercise of the paramount rights of bondholders as created in 1933 to reduce their claims to judgment promptly at maturity.[6]

Finally, the sole question in the allowance of interest on allowed claims is whether bondholders have been prevented from reducing their claims to judgment [either by individual or collective action or through a Trustee] or otherwise deprived of the use of their money.[7] If so, interest is allowed on claims from that date, assets being sufficient, and the ruling of the Circuit Court of Appeals on this subject would seem to be entirely beside the point and immaterial to the basic issue.

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[5] See cases footnotes 1 and 4 above.

[6] See cases footnotes 2 and 4 above.

[7] *Johnson* v. *Norris, supra; In re John Osborn Sons, supra; National Bank of the Commonwealth* v. *Mechanics National Bank;* and the state law is parallel.

f.

New York does not confuse "compound interest" with the allowance of simple interest on claims in equity proceedings.*

The local decisions, assets permitting, allow legal interest upon the full face amount of any debt or claim due at the time that creditors are stayed from suit—and that practice is not condemned by the local rule against "compound interest" which arises solely *ex contractu*. The two subjects are entirely separate and distinct (even if the local law be material to the allowance of interest by a Federal Court, which petitioner denies), though both are founded in just and practical considerations.

The Circuit Court of Appeals, in denying interest upon bondholders' claim for the 10 year accumulation of interest, viz; $1,286,646.43 due at maturity, conceived that the allowance of simple interest upon a claim constitutes "compound interest", citing and relying upon *Newburger-Morris Co.* v. *Talcott*, 219 N. Y. 505 (R 217).[8] It not only confused the two subjects but also contravened local law.

In New York claims "are presented when the receiver is appointed and that date fixes their status

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* As indicated above, petitioner does not consider this phase of the local law applicable—but the Circuit below has treated same at length as a controlling consideration herein.

[8] An action *ex contractu* and therefore clearly inapplicable in the allowance of interest upon equitable principles. There interest "compounded monthly" was properly disallowed. The authority on which it is based, *Young* v. *Hill* (67 N. Y. 162, 172, 174), holds the right to compound interest "*depends entirely*" upon contract and carefully points out that:

> "An agreement to pay simple interest upon the several installments of interest as they became due and the payments as made first to the payment of interest until all was paid, might not be unreasonable or inequitable."

and amount" (*People* v. *American Loan and Trust Company*, 172 N. Y. 371);[9] and interest at the contract rate is "credited upon the accounts of the debtor when the receiver takes possession", interest thereafter being allowed at the legal rate upon the whole "indebtedness as established at the time the receiver takes possession" (*People* v. *Merchants Trust Company*, 187 N. Y. 293, 297-99, on authority of *National Bank of the Commonwealth of the City of New York* v. *Mechanics National Bank*, 94 U. S. 437).[10]

The opinion below indicates a cleavage between the equity practice in New York and that in the Federal Courts of equity and bankruptcy. New York parallels the long established Federal equity practice as above shown and in *Hunting* v. *Blun*, 143 N. Y. 511 (1894), it is even held that the existence of an order restraining actions against a debtor are sufficient to give a claimant the status of a judgment creditor. To the same effect see *Lang* v. *Lutz*, 180 N. Y. 254, 260.

* * * *

It is essential that the local law be not so misstated by the Federal court.

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[9] Where equities were balanced between creditor and creditor and interest was denied on preferred claims because it would "exhaust the funds in the hands of the receiver and leave nothing for the preferred creditors" thus paralleling the *Vanston* case, *supra*.

[10] Specifically, and in line with the *Mechanics Bank* case, *supra*, it was held in an action against a stockholder that:

> "The creditor's debt consists both of principal and interest. He is just as much entitled to the latter as to the former and the liability to pay the debt must necessarily include the accrued interest up to the statutory limit. When that is reached, any further interest runs only upon that sum from the date of the commencement of the action . . . and the allowance of interest from the maturity of the debt was, therefore proper . . ." (*Wheeler* v. *Miller*, 90 N. Y. 353, 363).

POINT IV.

The unanimous consentient equities in this case rest unequivocally with bondholders.

". . . according to the traditional notions of Anglo-American law, this Court has chosen that rule as to interest which comports best with general notions of equity. *United States* v. *Sanborn*, 135 U. S. 271, 381, 34 L. ed. 112, 115, 10 S. Ct. 812; *Billings* v. *United States*, 232 U. S. 261, 58 L. ed. 596, 34 S. Ct. 421.

"Instead of choosing a rigid rule, the Court has drawn upon those flexible considerations of equity which are established sources for judicial lawmaking.

"Such is this Court's doctrine regarding the imposition of interest in cases where this Court has fashioned its own doctrine."

Jackson County v. *United States*, 308 U. S. 343.

"In the absence of an applicable federal statute it is for the federal courts to determine, according to their own criteria, the appropriate measure of damage, expressed in terms of interest, for nonpayment of the amount found to be due . . .

Here responsibility for delay in payment rests quite as much upon the debtor, who is chargeable with knowledge of its own obligation and the breach of it, as upon the creditor. **And in the meantime the debtor has had the use of the money, of which its default has deprived the creditor.** Interest upon the principal sum from the date of

default, at a fair rate, is therefore an appropriate measure of damage for the delay in payment . . ."

Royal Indemnity Co. v. *United States*, 313 U. S. 289.

Not one single act of this at-all-times-solvent debtor indicates concern for bondholders' rights or respect for its own contractual obligations.

The case does not present one single element or factor offering equitable excuse or justification for the conduct of this debtor in its dealings with its bondholders whose monies represented the greater part of debtor's working capital.

The equitable principles governing allowances of interest under the Bankruptcy Act, should not exempt this debtor from the payment of interest upon the roundly $7,000,000 obligation due bondholders on October 1, 1943.

Debtor's position at the time of filing its petition was one of its own choosing—entirely of its own making. It did not at any time have the excuse of insolvency.

Debtor never evinced any intention whatever of meeting its bonds at maturity, though possessed of assets far in excess of its debts, and able to show a surplus exceeding $2,500,000. During the entire prior 10 year extension debtor deliberately planned to omit such provision.

During the 10 year extension period, it had taken every advantage permitted by the Indenture to annually defer 2% of interest payable to bondholders—and used same to acquire large blocks of its bonds at depressed values [resulting in part no doubt from the decreased rate of 2% annual interest] and at a tremendous profit to itself of about $2,700,000.

On the eve of maturity, by resort to Chapter X, it obtained statutory stay of all actions by or on behalf of its bondholders and relegated them to the status of creditors holding "claims" under the Bankruptcy Act, instead of judgments. This left bondholders powerless to enforce their contractual obligations.

Throughout the 18 months of these proceedings, debtor was able to retain in its business the greater part of $7,000,000 due to bondholders, together with the profits and income therefrom—resisting even by appeal the interim distributions of principal and made no distributions of interest until compelled to do so by order of this Court.

Finding it expedient to refund with the stockholders, as they could always have done, debtor obtained dismissal at the end of some 18 months.

All was carefully planned and premeditated.

The purpose and the effect of debtor's voluntary petition herein was to obtain from bondholders an involuntary extension beyond maturity of their bonds by means of statutory stay, a stay which could never have been contemplated under the provisions of Section 5, Article VI of the 1933 Indenture.

The statutory stay herein gave this solvent debtor, and its co-respondent stockholder, exactly what they wanted, viz, an excuse for detaining the entire debt pending refinancing between themselves or extension by plan if possible. The income from that great sum not only enriched debtor but was a vital part of its estate, its working capital, and a source of great income to it, throughout the period of the stay.

Chapter X was thus resorted to *first;* because debtor had (by its own acts or omission) placed itself in a position where it could not *at the last minute* properly, expediently and economically dispose of assets

sufficient to meet its bonds when they matured; *second,* that debtor might retain among its resources during the proceedings the moneys due bondholders, including the interest deferred during the prior 10 year extension with all income therefrom; *third,* that it might attempt another extension from bondholders by mere partial payment of its obligation of overdue principal and overdue interest; *fourth,* to afford debtor extension and ample time, with all resources still in its possession, to arrange refinancing or refunding with its stockholder if desired; *fifth,* to stay bondholders' enforcement of the bonds without compensation to them [except contract interest on principal only] by asserting the inapplicable provisions of the 1933 Indenture relating to recoveries by the Trustee only.

Having thus obtained all that they desired—by way of deferments of interest, profits through purchase of bonds, deliberate default at maturity and an 18 month involuntary extension of the $7,000,000 obligation—**debtor and its stockholder have now obtained a "free ride" as to $1,286,646.43 and have been relieved of interest at the legal rate on $5,710,400 the face amount of the bonds from the date of maturity.**

Nothing in this case renders it inequitable to grant bondholders compensation for the use of their moneys by way of legal interest upon the lump sum arrears due since October 1, 1945—but every equitable consideration points to the necessity for so doing to properly and legally compensate bondholders for the loss resulting from detention of the whole debt due them at maturity of their bonds.

The equities in the present case are brought clearly into focus when the facts paralleling those in the *Mechanics National Bank* case, *supra,* and *Johnson*

v. *Norris, supra,* are considered. It is then seen that each bondholder was entitled "*ex aequo et bono*" to the amount of his claim as it existed on October 1, 1943 with interest at the legal rate to the date or dates of payment.

In every aspect of this case and from every viewpoint, the equities are unanimous and consentient, and unequivocally rest and "balance" with bondholders.

POINT V.

For the reasons stated in the petition and in this brief, it is respectfully submitted that the writ be granted.

Respectfully submitted,

PERRY A. HULL,
Counsel for Petitioner.

NEWMAN & BISCO,
Attorneys for Petitioner.

In the Matter

of

Reality Associates Securities Corporation,

Petitioner,

Manufacturers Trust Company, Intervening Petitioner,

Appellant,

vs.

Reality Associates Securities Corporation and Consolidated Reality Corporation,

Respondents.

REPLY BRIEF.

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Counsel for Petitioner.

Newman & Bisco,
Attorneys for Petitioner.

The Court Press, N. Y. C.

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Supreme Court of the United States

OCTOBER TERM, 1947.

No. 405

In the Matter

of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor.

MANUFACTURERS TRUST COMPANY, Indenture Trustee,

Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

REPLY BRIEF.*

Respondents have signally failed to negate the conflicts inherent in the decision below or the confusion bound to occur in its wake. It is significant that respondents have not cited in opposition a single authority apposite in this premise. Their argument shows up, in bold relief, the importance and anomalous character of the precedent below, and emphasizes the radical departure from established practice. We touch only the basic points, generally in the order and under designations given in their brief.

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* Manufacturers Trust Company is herein referred to as "petitioner"; its Petition and Brief as the "Petition" and the Brief of the Securities and Exchange Commission as the "S. E. C. Brief".

1.

A. The *Vanston* Case Does Not Oppose the Allowance of Interest on Claims Against a Solvent Estate or the Judgment Theory.

The judgment theory[1] and other equitable principles for allowance of interest on claims[2] apply *only* in event of solvency or a sufficiency of assets to pay all claims in full as well as interest thereon—where the equities must be balanced between a debtor and its creditors.

The *Vanston* case involved continued insolvency where an allowance of interest upon first mortgage coupons would have resulted in a corresponding loss to subordinate creditors.* Absent solvency, there was no point at which there could have been applied the judgment theory or any other theory as to allowance of interest on creditors' claims. Hence, Inland bondholders could not be accorded judgment rights against a debtor which had no equity in the assets (see Respondents' Brief, pp. 7-9) and the equities were weighed solely between classes of creditors.**

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* A fact not altered by assertions on rehearing that, by reason of the disallowance of such interest, assets were sufficient to permit some payment on debtor's stock.

** Respondents claim (p. 10) that insolvency was "immaterial" in the *Vanston* case because a sufficiency of mortgage collateral existed. But had assets been sufficient, all valid interest engagements would have been allowed. Hence respondents' argument only brings more clearly into focus (a) the extent to which this Court went in cutting across contract rights and even across the strict priority rule in order to assure equity and fairness in that case and (b) the fact that *only* insolvency made it necessary so to do.

1 *National Bank of the Commonwealth of the City of New York* v. *Mechanical National Bank*, 94 U. S. 437; *Re*: *John Osborn's Sons*, 177 Fed. 184 C. C. A. 2nd.

2 *Johnson* v. *Norris*, 190 Fed. 459, C. C. A. 5th; *Sexton* v. *Dreyfus*, 219 U. S. 339.

Certain equitable principles may apply in both solvency and insolvency, but the judgment theory and the principle finally applied in the *Vanston* case and the *Traphagen* case are applicable only in converse or opposite circumstances. They do not oppose each other, but are consistent and concordant.

The *Vanston* Case Differs in All Material Respects from the Case at Bar and Does Not Determine the Questions Here Raised.

Patently untrue is resonpdents' statement that the facts of this matter "are in every material respect identical with the facts" in the *Vanston* case (p. 8), for that case involved the "allowance of a claim" *ex contractu* for interest on coupons [not the allowance of simple interest upon a liquidated "claim"], several classes of creditors, an insolvent debtor, and post-petition interest unpaid for 16 years by Court order.*

In contrast, the principal question raised by the Petition concerns allowance of interest upon a matured claim of a single class of creditors for a liquidated sum consisting of principal and interest, all due at the time of the petition—and particularly the base for computation of such interest, viz whether interest due

* Respondents' assertions (p. 10) only point up the error of the Circuit Court in denying in reorganization proceedings anything but interest "contracted for" or made the subject of pre-petition "bargain".

They state that the *Vanston* case refused to enforce a contract right to interest on interest because "the delay in payment was . . . for the benefit of all parties". But this Court there pointed out that interest would be allowed when compatible with equitable principles invoked in cases of solvency or "where an estate is ample", and contract interest on coupons was then denied as not in accord with equitable principles because "enriching" one class of creditors with "corresponding loss" to another.

at maturity can constitute a "claim" or part of a "claim" under Section 63 (a) 1 of the Bankruptcy Act for the purpose of allowing interest (SEC Brief, pp. 3, 8, 16). Such an allowance of interest depends solely upon equitable principles, independent of contract and the strict propriety rule.

The *Vanston* and *Traphagen* Cases Afford Precedent for Equitable Action in This Case, Even If It Be Assumed *Arguendo* That Bondholders Are Bound by the Indenture as to Post-Maturity Interest.

The *Vanston* case, "cut across the face"* of a presumably valid contract to obviate a situation deemed incompatible with the equitable principles governing bankruptcy distributions. *Fleming* v. *Traphagen* (329 U. S. 686) cut across the face of an admittedly valid contract even though the mortgage security was adequate to pay same.

If, on such authority, a reorganization court in balancing equities between creditors must cut across the face of a valid contract to assure fairness and equity—it should do likewise in balancing equities between creditors and debtors.

To the extent that debtors, possessed of means with which to pay such interest, avoid payment of interest on money profitably used during reorganization, they are certainly "enriched"**—and creditors obviously

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* Phrase quoted as coined by respondents. The better choice of language would indicate that a reorganization court, as a court of equity, simply subordinates the troublous terms of the contract to the paramount demands of fairness and practical justice. (See Petition, pp. 28-29, 34-35 and Point IV.)

** Debtor's actual net income during the Chapter X Proceedings was $494,821.44 before Trustees' fees and reorganization expenses and without computing capital losses upon the sale of real estate which did not affect debtor's income. This is more than 7% on bondholders claim of $6,977,046.43.

"suffer a corresponding loss" of use of the moneys due them at the time of the petition.*

Such situation is no more compatible with any known principle of equity than was that in the *Vanston* and *Traphagen* cases. The inequity can only be eliminated, and the equities fairly balanced, by cutting across the face of any contract (or pre-petitioned "bargain") which gives rise thereto and by requiring payment of interest on the whole amount withheld from creditors.

In paying interest on moneys profitably used in its business a debtor is not deprived of anything—as one seeking equity, it does equity. By the same token creditors are recompensed for the loss of income on moneys used by the debtor and which, but for the stay, would have been the subject of summary judgment bearing 6% interest in New York as of a date approximating the filing of the petition.

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* Respondents assert (pp. 23-27) that in a reorganization proceeding creditors do not actually "sustain a loss" and are "not damaged" because such proceedings are for their benefit as well as that of a debtor and its stockholders. That argument is unrealistic as well as contrary to the rule that, where assets permit, interest is always allowed on "claims" against a bankrupt—a rule which to date has no exception.

Actually, more occasion exists for invoking the judgment theory in Chapter X where the going business as an entirety is returned to debtor and stockholders, than in bankruptcy or equity where the business is lost in liquidation.

B. The Uniform Practice in Computing the Amount of a "Claim" in Bankruptcy or Reorganization Proceedings Differs From, But Does Not Oppose, the Allowance of Interest Upon the Full Amount of a "Claim" Matured and Liquidated at the Time of the Petition.

(i) All Cases Cited by Respondents as to the Rate of Interest Are Foreign and Inapplicable to the Present Problem.

Respondents cite *Coder* v. *Arts* (213 U. S. 510), for the proposition that contract terms prevailed after the filing of the petition irrespective of equities given recognition in Bankruptcy. But the "cut-across" principle of the *Vanston* case is a perfect example to the contrary. Furthermore, in *Coder* v. *Arts* no question was raised as to either (a) interest upon a "claim" matured at the time of the petition or (b) any difference between the contract and legal rates of interest.*

Obvious distinction exists between (a) computing the amount of a "claim" to a fixed date pursuant to a Plan of Reorganization for an insolvent debtor, and (b) the equitable allowance of interest, where assets are sufficient, upon an allowed "claim" which matured at the time of the petition. In the former, no occasion whatever exists to consider the allowance of interest upon "claims" as already allowed under Section 63 (a) 1.

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* There a Trustee, challenging the legality of a mortgage, sold the mortgaged property which brought more than the mortgage debt and was, therefore, directed to pay the mortgage debt from those proceeds. (15 L. R. A. [N. S.] 372, 379). That principal does not conflict with the *Vanston* case or the principles here advanced on behalf of creditors.

In the railroad cases cited by respondents,[3] interest *ex contractu* was computed to a given date solely for the purpose of issuing, pursuant to plan, new securities of lessor rank or amount than the original securities. Each of these railroad cases, without exception, is, therefore, in all respects inapposite to the problems raised by the Petition.

(ii) The Interest on Interest Cases Cited by Respondents Are Clearly Inapposite.

We have just shown that the *Ecker* case and the *Rock Island* case are inapplicable herein.

In citing *In re Norcor Mfg. Co.* (36 F. Supp. 978 E. D. Wis. 1941), respondents omitted to explain that same involved a claim for royalties which was not predicated upon a contract calling for interest as part of the obligation. Clearly, therefore, that case is inapposite and the District Court below has pointed out at length just why that case is not at variance with creditors' position in the case at bar (R. 180, fol. 540).

C. Respondents' Treatment of Cases Cited in Support of the Petition Only Confirms That the Conflict Inherent in the Prevailing Opinion Below is Self-Evident.

In stating (p. 20) that the *Osborn* case "did not involve any question of interest upon interest" re-

[3] *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448; *Brooks* v. *St. Louis & San Francisco Railway Company*, 153 Fed. (2) 312; *Chicago Rock Island & Pacific Railway Reorganization*, 157 Fed. (2) 241; *Missouri Pacific Railroad Reorganization*, 64 Fed. Supp. 64; *Minneapolis, St. Paul & Sault Ste. Marie Railway Company Reorganization*, 48 Fed. Supp. 330; *Chicago, Milwaukee, St. Paul & Pacific Railway Reorganization*, 145 Fed. (2) 299; *In re Wisconsin Central Railway Co.*, 63 Fed. Supp. 151.

spondents avoid the **obvious and very important facts** viz: (1) the Circuit Court below distinguished its ruling herein from its ruling in the *Osborn* case by stating that in said case "the bankrupt had made no contract providing for the payment of interest", (2) thus indicated that in Chapter X it would only allow interest *ex contractu* and (3) in addition established a precedent which splits all claims into two categories—viz. claims for interest which would not be entitled to interest, in event assets were sufficient, and claims for principal which would.

Error Is Evident in Respondents' Treatment of the *Osborn* case and *Johnson* v. *Norris* and as to the Effect of the Ruling Below in Respect to Interest Upon Claims Consisting Wholly or Partially of Interest.

The *Osborn* case, necessarily involved only claims allowed under Section 63 (a) 1 of the Bankruptcy Act but made no distinction between claims representing interest or claims representing principal. It shows no exception to the rule that all claims allowed under said Section have the same status.

Section 63 (a) 1 specifically provides that provable debts include "interest recoverable" on the date of the petition. When so proven such a debt becomes a "claim". Undeniably a "claim" for interest due at the time of the petition may be voted and is otherwise accorded the same status, rights and "dignity" as any other claim (see authorities at p. 20 Petition).

A claim consisting in part of interest never has

been denied the right to interest, *Johnson* v. *Norris* (190 Fed. 459).*

Respondents' arguments simply make more apparent the urgency for review and revision herein by *first* denying the same rights and incidents to a claim for interest as to a claim for principal and *second* denying any rule in Chapter X for payment of interest on claims matured at the time of the petition, where assets permit, unless arising *ex contractu*.**

D. *Contra* Assertions of Respondents, Important Constructions of the Bankruptcy Act Are Involved.

It is a matter of utmost importance that it be determined whether Sections 102, 106, 114, 115 and 200 take effect in a Chapter X reorganization, where the

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* Respondents assert (p. 21) that *Johnson* v. *Norris* "does not present a conflict with the decision below". In view of the cogent and directly analogous facts of that case (quoted Petition, pp. 30-31), the application herein of entirely different principles makes the conflict self-evident.

** If this view be sustained, then [A] post-petition interest on Chapter X claims will be allowed only on the base and at the rate provided by contract, affording inequitable advantages to such contracts, [B] creditors in Chapter X will be deprived of rights long recognized in straight bankruptcy, [C] notwithstanding the rule in the *Vanston* case (see footnote 8 thereof), the provisions of §§ 102, 106, 114, 115, 200 and 63A(1) of the Bankruptcy Act would not be applicable in Chapter X if the debtor be solvent and [D] **an entirely new and novel relationship will exist between creditors and solvent debtors in Chapter X and even in straight bankruptcy**—one heretofore unknown in equity or bankruptcy and in direct conflict with the practice long established in such matters—**for a claim for interest due at the time of the petition would not carry the same rights as other claims.**

It must be clear that every time any one of those subjects is raised the decision of the Circuit Court of Appeals herein will be cited in opposition to the rights of creditors. The consequent conflict and confusion is not to be underestimated.

debtor is solvent, inasmuch as the *Vanston* case clearly indicates that same are applicable where there is insolvency (footnote 8 thereof).

Of like significance is the question whether under Chapter X a claim representing interest due at the time of the petition should have a different and lesser status and different and lesser incidents than a claim for principal due on the same date.

Is the decision of the Circuit Court below to stand as precedent and authority that the Congress did intend to deprive creditors in Chapter X of rights against a solvent debtor which creditors of a bankrupt would have under Section 63 (a) 1?

It should be for this Court to weigh and determine whether, as claimed by respondents (p. 25), Chapter X contemplates "the continuance of the business of the debtor, a continuation of the contractual relationship between the debtor and its creditors", and whether, then, Chapter X contemplates the equitable continuation of a solvent debtor's obligation to pay for the use of moneys withholden from creditors during a reorganization proceeding.

Practically all bankrupts are insolvent, yet are obliged to pay interest on claims, where the estate is sufficient, as a reciprocal equitable duty resulting from the bankrupt's right to obtain the statutory stay *ex parte* (*Johnson* v. *Norris, supra*). This Court alone should determine whether a solvent debtor is to be exempt from the corresponding equitable obligation to pay, for every equitable consideration and authority supports the theory that the Congress intended the same equitable rule to hold true in reorganizations as in bankruptcy where equitable principles prevail (*Vanston Bondholders Protective Com.* v. *Green, et al., supra*).

Not one of the many decisions cited by respondents hold that in a Chapter X proceeding interest is not allowable as in bankruptcy.

Even the prevailing opinion below (R. 214-215) admits

> "the point does not appear to have been discussed"

and, as we have shown ("B" above), could only cite cases which were in all respects inapposite.

There is, however, adequate authority to the contrary, set forth in both the Petition and the SEC Brief.* The cases which allow interest where assets are sufficient [including the judgment theory] show no exceptions to such authority.

2.

The Construction Given the Contract Below Violates Contract Rights of Creditors Under the Local Law and Denies to Them a Just Balance of Equities in This Case, as Shown in Points IV and V of the Petition.

3.

It Is Respectfully Submitted That the Writ Be Granted.

Respectfully submitted,

PERRY A. HULL,
Counsel for Petitioner.

NEWMAN & BISCO,
Attorneys for Petitioner.

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* Debtor's statement (p. 23) that certain decisions were made prior to the *Vanston* case does not answer *fact* #1 that such cases represent the practice as now established or *fact* #2 that the interpretation of the *Vanston* case given below and by debtor is radical departure from such practice—indisputable evidence of conflict.

IN THE

Supreme Court of the United States

October Term, 1947

In the Matter of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

No. 405

MANUFACTURERS TRUST COMPANY, Indenture Trustee,
Petitioner,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
Respondents.

No. 406

EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,
Petitioners,

v.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
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No. 407

VANNECK REALTY CORPORATION,
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v.

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Respondents.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF PETITIONS

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1947

In the Matter of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor.

No. 405

MANUFACTURERS TRUST COMPANY,
Indenture Trustee, *Petitioner,*

v.

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The respondent Consolidated Realty Corporation is a corporation all of whose stock is owned by the Reconstruction Finance Corporation. Consolidated Realty Corporation, in turn, owns all of the stock of the debtor, Realty Associates Securities Corporation. The Securities and Exchange Commission is a statutory party herein pursuant to Section 208 of the Bankruptcy Act, 11 U.S.C. § 608, and its position in the instant matter in support of the petitions for certiorari is contrary to that of the Reconstruction Finance Corporation. In view of the conflicting positions of these two governmental agencies, I am authorizing each to present a brief in its own name. *Cf. Consolidated Realty Corp.* v. *Meredith, et al.*, 323 U.S. 758 (1944).

PHILIP B. PERLMAN,
Solicitor General.

OPINIONS BELOW

The opinion of the District Court (R. 171) is reported at 66 F. Supp. 416. The opinion of the Circuit Court of Appeals (R. 209), modifying the order of the District Court, is reported at 163 F. 2d 387.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 23, 1947 (R. 222). The petitions for writs of certiorari were filed on October 20, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 28 U.S.C. §347(a), and Section 24(c) of the Bankruptcy Act, as amended, 11 U.S.C. §47(c).

QUESTIONS PRESENTED

(1) Whether the substantive rights of creditors to accrue interest on their claims are less in a Chapter X reorganization than in straight bankruptcy?

(2) Whether creditors holding matured and undisputed claims against the debtor on the date of a voluntary Chapter X petition, which claims consist of unpaid principal and interest, and which were prevented from being reduced to judgment by the debtor's resort to Chapter X, are entitled as against a sole stockholder upon dismissal of the proceedings and the return of the properties to the solvent debtor (a) to interest on the entire amount of their claims, including that portion representing interest accrued prior to the filing of the petition, and (b) to accrue such interest as may be allowed at the rate applicable to judgments rather than the contract rate.

STATEMENT OF FACTS

The debtor, Realty Associates Securities Corporation, deals in mortgages and other real estate interests (R. 4-5) and the respondent, Consolidated Realty Corporation, is its sole stockholder (R. 7). The Chapter X petition was filed by the debtor on September 28, 1943 in contemplation of the imminent maturity of a large publicly held bond issue due three days later, October 1, 1943 (R. 6). This was the principal (and practically the sole) indebtedness of the debtor, and its petition alleged that while the value of its assets exceeded "total liabilities inclusive of its capital stock," a forced sale might bring in less than the true value of the assets to the detriment of the stockholder interests (R. 6).

The bonds were originally issued in three series of $5,000,000 each in 1925, 1927, and 1928, due 1937, 1939, and 1943, respectively (R. 5; 8), and bore unconditional rights to 6% interest semi-annually (R. 42; 52; 62). On July 10, 1933, when some $12,450,000 principal amount was still outstanding, the debtor filed a voluntary petition in bankruptcy (R. 5; 8). The bankruptcy proceeding was terminated the following year as the result of a composition effected by the debtor. The composition involved a 15% payment on account of the outstanding indebtedness, an

extension of the remaining debt (including all three bond issues) to October 1, 1943, and a reduction in the interest rate thereon from 6% unconditionally to 5% "if earned." (R. 78). An amended indenture, dated as of July 10, 1933, defined "earnings" for interest purposes to permit deductions of capital losses provided that such losses could not be used to reduce interest below 3% per annum (R. 78; 92). Unpaid portions of the 5% annual interest were made cumulative and payable out of future earnings, or unconditionally at maturity (R. 10; 92). As a result, instead of being wiped out by bankruptcy, the debtor obtained a ten year moratorium which included substantial alleviation of its interest obligation.

During the moratorium years which followed, the debtor paid approximately 3% per annum, and took advantage of the unique definition of earnings to defer the remainder, thus retaining for its own use money which otherwise would have been payable to the bondholders.[1] As the extended maturity date approached, the debtor found itself still owing $5,710,400 in unpaid principal (R. 6; 191) and $1,286,646.43 in unpaid interest (R. 5; 10; 191). According to the Chapter X petition, it then had assets with a book value of nearly $13,500,000 (App.[2] b4), including approximately $1,261,000 in cash. (App. b7) and $1,760,069 in readily marketable securities (App. b3). Despite the availability of liquid assets more than sufficient to satisfy all interest claims, no payment of these claims was proffered. Instead, the debtor first attempted, in July of 1943, to obtain another voluntary extension and composition of the indebtedness and, failing in this, resorted to Chapter X to stave off the enforcement remedies normally available to the bondholders.

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[1] See Statement of Earnings for the Six Months Ending April 30, 1943 (R. 138), for an illustration of the deduction of capital losses.

[2] "App." refers to the Appendices to Petitioners' Brief in No. 405, Filed Pursuant to Stipulation Dated September 26, 1947.

The Chapter X proceeding lasted nearly 18 months and was dismissed on April 2, 1945 on the petition of the debtor and its sole stockholder, Consolidated Realty Corporation (R. 7, 25). By that time the debtor's business situation and the value of its assets had improved sufficiently to persuade the stockholder respondent to advance it the funds necessary to discharge the indebtedness. The petition for dismissal, however, denied any liability for interest beyond 5% on the unpaid principal to April 15, 1945, the date fixed for payment and settlement (R. 26; 172). The court's dismissal order, provided for payment of the undisputed claims for principal and interest, and for a reserve to be retained by the Chapter X trustees sufficient to pay any additional amounts which might be allowed (R. 26 *et seq.*). Jurisdiction was reserved to adjudicate, *inter alia*, the dispute as to the proper interest rate and base, the specific issues with respect thereto being:

(1) Whether interest is payable after the institution of the Chapter X proceedings on that portion of the bondholders' claims which represented unpaid interest accrued prior to that date; and

(2) Whether interest on the bonds, matured as of October 1, 1943, accrued during the Chapter X proceedings at the rate of 5%, as the debtor and its sole stockholder contend is provided by the indenture, or at 6%, the judgment rate which the bondholders contend should equitably be applied since they were prevented from obtaining judgment by the debtor's petition for reorganization.

The District Court held that the bondholders were entitled to 6% judgment interest on their entire claim including unpaid principal and interest accrued to the date of maturity and the filing of the Chapter X petition [3] (R.

[3] Throughout these proceedings the date of the Chapter X petition and the maturity date of the bonds have been treated essentially as one; for, as previously noted, the petition was

171-181; 191). On appeal by the debtor and its sole stockholder, a majority of the Circuit Court of Appeals (Judges Swan and Learned Hand), construed the indenture as providing for a 5% rate of interest on the unpaid principal of the bonds after maturity,[4] and held that interest was payable at that rate and only upon the portion of the bondholders' claim which represented unpaid principal (R. 217). The judgment of the District Court was modified accordingly (R. 218). Judge Clark, dissenting, expressed the view that equitable considerations required the allowance of the 6% judgment rate of interest on the bondholders' entire claim, including interest accrued prior to the abortive Chapter X proceeding (R. 218).[5] The instant petitions for certiorari followed.

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filed only three days earlier and admittedly in contemplation of the imminent maturity of the bonds.

[4] While we believe that the indenture, properly construed, does not contain any applicable post-maturity rate of interest on the bonds and that, therefore, they bear the legal rate of interest after maturity, we do not press at this time our disagreement with the decision of the court below on this point. This interpretative issue is of no significance if petitioners are correct in contending that interest should be allowed on their claims as if they had been reduced to judgment.

[5] The Indenture Trustee had also appealed from another portion of the District Court's order which applied an interim payment first towards reduction of the bondholders' original claim, rather than upon the interest which had accrued during the course of the Chapter X proceedings (R. 191; 197). The Circuit Court found that such application produced a difference in the amount to which the bondholders were entitled only if more than 5% interest were payable, and in view of its holding as to the proper interest rate and base, regarded this aspect of the appeal as academic. Accordingly, this portion of the District Court's order was affirmed (R. 218).

ARGUMENT

The petitions present questions of importance in the administration of Chapter X of the Bankruptcy Act which we believe should be decided by this Court. The rights of creditors holding matured and undisputed claims against a debtor to accrue interest on those claims from the date of the petition at the rate applicable to judgments where, but for the petition, they would be entitled to reduce those claims to judgment and receive interest thereon at the judgment rate, is a federal question which, in the context of a reorganization proceeding, has not been, but should in our opinion be, considered by this Court. Improved business conditions and appreciations in asset realization values during the past few years have provided surpluses after payment of the principal of creditors' claims in many estates being administered under Chapter X, with resultant conflict between creditors and stockholders as to the validity and extent of the interest claims payable out of such surpluses. Thus, the question here presented is of recurrent importance under present business conditions.[6] We believe it was erroneously decided by the majority of the court below. In our opinion, the decision below introduces novel distinctions between allowable claims in straight bankruptcy and in Chapter X reorganizations which are unwarranted by the provisions and underlying purposes of the Bankruptcy Act. The determination below also runs counter to well established equitable doctrines applicable in federal liquidation and reorganization proceedings.

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[6] For example, aspects of this problem have recently been presented in the following reorganizations in which the Commission is a party: *In re Childs Company*, 69 F. Supp. 856 (S.D.N.Y. 1946), and S.E.C. Corp. Reorg. Release No. 67, C.C.H. Bankruptcy Law Service, par. 55,734; *In re United States Realty & Improvement Co.*, S.D.N.Y., Bkcy. No. 83280, order approving plan dated May 14, 1946, par. 18; *In re Equitable Office Bldg. Corp.*, S.D.N.Y. Bkcy. No. 78476, order approving plan dated October 24, 1947, appeals pending in the court below.

1. As previously noted, the decision below introduces a distinction between the allowable claims of creditors in straight bankruptcy and in Chapter X reorganization which is wholly unwarranted by the statute. The court below expressly recognizes that "allowed claims in bankruptcy are of the same efficacy as judgments with respect to bearing interest, where the assets of the bankrupt are sufficient" (R. 214). It had expressly so held in *In re John Osborn's Sons & Co.*, 177 Fed. 184 (1910),[7] a straight bankruptcy case, relying upon the ruling of this Court in *National Bank of the Commonwealth of New York* v. *Mechanics National Bank*, 94 U.S. 437 (1876). The latter case involved the liquidation of a New York bank under the National Banking Act [8] and the depositors were held to be entitled to interest on demand deposits from the date of demand at the rate applicable to judgments in the State of New York. This Court then stated (94 U.S., at 439):

> "If these claims had been put in judgment * * * the result as to interest upon the judgment would have been the same. It was unnecessary to reduce them to judgment, because they were proved to the satisfaction of the comptroller. After they were so proved, they were of the same efficacy as judgments, and occupied the same legal ground."

Insofar as the decision below treats the principal amount of the bonds as differing from the accrued interest as respects its status as an interest bearing claim, the decision is contrary to Section 63(a)(1) of the Act, 11 U.S.C.

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[7] Appellants in the court below attempted to distinguish the *Osborn* case because of the failure of the bankrupt in that case to make any contract for the payment of interest. The court below stated, however (R. 214): "Assuming without decision that the attempted distinction would be invalid in an ordinary bankruptcy, we are not convinced that the 'judgment theory' is applicable in a Chapter X reorganization. . . ."

[8] Recently, in *Vanston Bondholders' Protective Committee* v. *Green et al.*, 329 U.S. 156 at 165 (1946), in dealing with a specialized interest problem in a Chapter X proceeding, this Court referred to bank liquidation cases as involving analogous principles.

§ 103(a)(1), which is applicable to a Chapter X proceeding as well as an ordinary bankruptcy, and which provides that an allowable claim shall include a fixed liability of the debtor, together with any interest thereon which would have been recoverable at the date of the petition. Under this provision principal and interest accrued to the date of the petition are treated as part of the creditor's single claim against the estate, just as they would be treated as a single claim if reduced to judgment. Thus, in *Johnson* v. *Norris*, 190 Fed. 459 (1911), the Fifth Circuit Court of Appeals ruled that interest was payable on claims which, as filed, included interest accrued prior to the date of the bankruptcy petition, before any part of a surplus held by the trustee could be turned over to the bankrupt.[9] In the present case, at the date of the Chapter X petition the bondholders' claim against the debtor amounted to $6,997,046.43, of which $1,286,646.43 represented interest accrued and accumulated prior to the Chapter X proceedings. Contrary to the statute, the holding below denies the creditor the full right to treat the accrued interest as part of his claim for the purpose of an allowance of interest.

The majority of the Circuit Court of Appeals differentiated straight bankruptcy from reorganization, and decided that, in the latter proceeding, creditors possessing matured and undisputed claims which would have been reduced to judgment but for the Chapter X petition, were not entitled to have their claims for principal and accrued interest treated as if reduced to judgment because, in the majority's view, Chapter X contemplates a "moratorium" for the debtor precluding the recognition of those claims as "peremptory demands, like judgments, upon which dam-

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[9] In *Ohio Savings Bank & Trust Co.* v. *Willys Corp.*, 8 F. 2d 463 (1925), the court below, in an equity receivership proceeding, applied the same theory in allowing interest on creditors' claims, part of which had represented interest accrued prior to the institution of the proceedings.

ages in the form of interest for delay in payment" is payable (R. 214).[10]

The attempted differentiation is apparently predicated upon the assumption, a fallacious one as we show below, that the greater remedial restrictions imposed by Chapter X in the interest of facilitating reorganization, require a holding that the claims of creditors in Chapter X are less than in straight bankruptcy. On the contrary, Section 200 (11 U.S.C. §600) provides that the rights of creditors with respect to the property of the debtor shall be the same in Chapter X as in straight bankruptcy unless "inconsistent with the provisions of this chapter"; and there are no provisions which would indicate that the substantive claims of creditors are less in Chapter X than in straight bankruptcy. If anything, they may be greater: See *e.g.*, the broad definition of "claims" in Chapter X which is set forth in Section 106(1), 11 U.S.C. §506(1).[11] So far as we know, this purported distinction, which conflicts with basic provisions of the Bankruptcy Act and runs counter to its underlying policy, is made for the first time by the court below.

2. Apart from the express statutory mandate that the substantive rights of creditors in Chapter X shall conform

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[10] The decision below does not push the concept of moratorium to the point of disallowing as between creditors and the debtor any "damages in the form of interest," a result recognized to be contrary to settled authority. Instead, that portion of the claim which represents accrued interest, assumed to be a non-interest bearing claim under local law unless reduced to judgment, was continued as a non-interest bearing claim and the bondholders were allowed 5% interest on the unpaid principal, which the court below held to be the post-maturity interest rate provided by the indenture. See pages 12-17, *infra*, where we discuss the inequity of the concept of moratorium so applied.

[11] Section 106(1) provides that claims recognizable in Chapter X include "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of the Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent."

to those in ordinary bankruptcy, there are other important reasons why the substantive scope of a creditor's claim should not depend on whether Chapter X or straight bankruptcy is invoked. Thus, we believe that the choice of proceedings should depend upon the prospects of realizing or preserving through reorganization, values for the totality of interests affected which might be lost in a straight bankruptcy proceeding. However, if the amount of the creditor's claim which will be recognized is less in a Chapter X proceeding than in ordinary bankruptcy, basically irrelevant considerations will be introduced which will tend to intensify conflicts of interest between different classes of security holders as respects the appropriate choice of proceeding. In a case, such as the instant one, involving a controversy between a single class of creditors and the stockholder interests, the decision below can only have the effect of stimulating creditor opposition to the reorganization process.

The decision below also creates certain other difficulties in the administration of the Bankruptcy Act. For example, Section 238(1), 11 U.S.C. § 638(1), provides that where a Chapter X proceeding is ultimately converted into a straight bankruptcy liquidation, the proceeding shall be conducted so far as possible in the same manner and with like effect as if an involuntary petition in bankruptcy had been filed at the date of the Chapter X petition and a decree of adjudication entered when the Chapter X petition was approved. It would seem to follow from the doctrine enunciated by the majority of the court below that although judgment interest would be denied during the Chapter X "moratorium", it would be required to be allowed retroactively to the date of the original reorganization petition in the event that the proceedings were transferred to straight bankruptcy. It hardly needs to be emphasized that a creditor's substantive rights should not be based upon such a contingency.

Again, the determination below would afford an inequitable advantage to certain creditors in a case where,

because of special circumstances unrelated to the propriety of preferential treatment of their claims, these creditors were permitted by the Chapter X court to pursue their claims to judgments after the filing of the petition.[12] In the event that there are assets available for the payment of interest on allowed claims, the ruling below would require that interest be payable on the newly acquired judgments at the judgment rate while other creditors are relegated to the contract rate, which may be considerably lower. A similar situation would be presented had the instant petition been filed after the maturity date of the bonds (instead of before) and had some of the bondholders succeeded in obtaining judgments on their claims prior to the petition. The inequality which would result were the "moratorium" concept of the court below applied in these situations obviously conflicts with the underlying statutory policy of equality of distribution.[13]

3. In developing its concept of a "moratorium" purpose of Chapter X the court below misconceived the purpose of the restraints which Chapter X imposes upon the entry of judgments and introduced an arbitrary rule in conflict with the flexible equitable considerations governing the allowance of interest claims which this Court so clearly enun-

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[12] The fact that a stay of lawsuits against the debtor rests in the discretion of the reorganization court and is not mandatory under the statute [see Sections 57d, 113, 116(4), 11 U.S.C. §§ 93a, 513, 516(4)] negates the "moratorium" concept of the court below as a statutory prohibition against judgments and their incidents after institution of reorganization proceedings, including the accrual of interest on claims as if they had been reduced to judgment.

[13] Section 63(a)(5) of the Act, 11 U.S.C. § 103(a)(5), for example, endeavors to preserve the statutory policy of equality of distribution among creditors by providing that where claims are permitted to be reduced to judgment after the filing of a petition, costs and interest accrued between the date of the petition and the entry of judgment shall not be allowed as part of the creditor's allowable claim; but this does not destroy its status as a judgment.

ciated in *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156 (1946).

The purpose of the customary stay of action which the reorganization court has discretion to grant is to avoid a race of the diligent to obtain preferential access to the assets, to insure equality of treatment among creditors, to prevent piecemeal executions, and to provide an orderly and equitable liquidation or reorganization. The normal procedural remedies are thus rendered unavailable, but the purpose of this restraint does not include denial of the substantive rights to which creditors would have been entitled absent the statutory proceedings. As the court below recognizes, at least as regards a straight bankruptcy proceeding, those substantive rights include judgment rights to interest where the entry of judgment has been precluded by the institution of proceedings under the Bankruptcy Act. The greater restrictions imposed by Chapter X upon the exercise of normal creditor remedies, we believe, do not warrant diminution of the allowable claims of creditors in a reorganization under that Chapter. On the contrary, those added restrictions and the slower process of realizing upon a claim in Chapter X make it all the more imperative that the substantive rights of creditors be fully protected in the reorganization process.

The reasoning of the majority below that Chapter X contemplates a "moratorium" which precludes alteration of the contractual relationship between the debtor and its creditors prior to the effective date of a plan overlooks the fact that the contract dealt with would be incomprehensible unless negotiated with reference to the creditor's expectations of obtaining judgment rights. The contract itself provided for a 10-year moratorium of limited scope, including a reduction in the contract rate of interest from 6% to 5% together with contingent provisions for deferring the interest claim to maturity. Regardless of the dispute as to whether the modified contract should be construed as continuing interest at 5% after maturity in the absence of

action by bondholders to enforce their claims, it is inconceivable that bondholders would have consented to the composition had they understood that the debtor could by institution of reorganization proceedings obtain a further moratorium in which the accumulated arrears of interest would be treated as a non-interest bearing claim and the return on principal would continue reduced below the judgment rate.

In denying interest on that part of the bondholders' claim which represented prior unpaid interest, the majority below relied largely upon a local New York policy against the compounding of interest, a policy which it conceded would be inapplicable if the claims were treated as if merged into judgment (R. 217).[14] The court below, however, refused to treat the indebtedness at the date of the petition as a single interest bearing claim. In our view, the holding below is contrary to the provisions of Section 63(a)(1) of the Bankruptcy Act, discussed *supra*, pp. 8-9, and, in addition, contravenes the equitable considerations which this Court, in the *Vanston* case, *supra*, held applicable as respects the allowance of interest in a Chapter X reorganization to the exclusion of any rules under state law.

In the *Vanston* case, which involved a Chapter X reorganization, this Court pointed out that "the touchstone of each decision on an allowance of interest in bankruptcy and receivership has been a balance of equities between creditor and creditor, or between the creditors and the debtor" (329 U.S., at 165). "Where an estate (is) ample to pay all creditors and pay interest even after the petition was filed," this Court observed, "equitable considerations (are) invoked to permit payment of this interest to * * * creditor(s) rather than to the debtor" (329 U.S., at 164). While the actual holding in the *Vanston* case was to deny interest on interest coupons which had matured after the institution of reorganization proceedings, and which were

[14] See also the New York cases cited *infra* n. 16, which treat allowed claims in local insolvency proceedings as if merged into judgments.

left unpaid in consequence of restraints imposed in the course of judicial administration, this interest denial was based solely upon a merging of the equities as between the classes of security holders affected. The estate was insolvent and the proceedings had extended over a period of sixteen years—from equity receivership, to Section 77B, and eventually into Chapter X. The accruals of interest on the overdue coupons were so large that they ate deeply into assets which otherwise would have been available to the junior creditors. To have allowed this additional interest on interest would have enriched the first mortgage bondholders at the expense of the junior creditors whose equity in the estate would have been seriously diminished by the protraction of the proceedings. In effect, allowance of the interest sought by the first mortgage bondholders would have placed upon the junior creditors the expense of a reorganization instituted for the benefit of all creditors.

A similar equitable approach was taken by the court below in the railroad reorganization case of *In re New York, New Haven & Hartford R.R.*, 147 F. 2d 40 (1945), *cert. denied*, 325 U.S. 884 (1945), in which a secured creditor had been enjoined from realizing on pledged collateral at a time when it had substantial market value. By the time the reorganization plan was approved the collateral had become worthless. Under these circumstances the court below held (147 F. 2d, at 48):

> "*The damage to the banks resulting from it (the injunction) ought not equitably to be saddled on them but on the parties for whose supposed benefit the restraint was imposed, and particularly is this true where the decline in the value of the collateral resulted from an act of the debtor itself.* In our opinion fair and equitable treatment requires that the damage caused the banks should be made good to them and that they should be classified as secured creditors to the extent to which they could have realized on their collateral had they not been restrained from selling . . ." (Italics supplied.)

Analogous principles have been applied in other federal liquidations and reorganizations,[15] and, although not controlling in these proceedings, the New York courts give effect to the same equitable considerations in insolvency proceedings.[16]

The instant controversy presents the converse of the *Vanston* case and involves considerations resembling those present in the *New York, New Haven & Hartford R.R.* case. We believe that the equitable doctrines there enunciated require denial of the windfall which the debtor's sole stockholder would reap if the bondholders' matured and undisputed claims were not treated as if merged into judgment. As the reorganization petition substantially admits, the proceedings were instituted for the purpose of safeguarding the stockholder's equity in the debtor's assets, and were dismissed only after the debtor's financial condition had improved sufficiently to warrant that stockholder in advancing funds to discharge the debt. In depriving the bondholders of all rights to interest on a substantial part of their claim which was reducible to judgment at the date of the petition, and in denying them the judgment rate of interest on the balance, a rate to which they would have

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[15] Thus, in *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (1917) in holding that rents and profits belonged ultimately to a mortgagee who was restrained by the bankruptcy court from collecting them pending bankruptcy, the Third Circuit Court of Appeals observed (248 Fed., at 115): "As we are dealing in this case with the equitable administration of bankrupt assets, where creditors' *legal rights are preserved but where their legal remedies are lost and equitable remedies are substituted, equity requires the new remedies to be as effective as the old in protecting and enforcing such rights.*" (Italics supplied.)

See also, *Associated Co.* v. *Greenhut*, 66 F. 2d 428 (C.C.A. 3, 1933), *cert. denied*, 290 U.S. 696 (1933); *In re Wakey*, 50 F. 2d 869 (C.C.A. 7, 1931); *Mortgage Loan Co.* v. *Livingston*, 45 F. 2d 28 (C.C.A. 8, 1930); *In re Torchia*, 188 Fed. 207, 208-209 (C.C.A. 3, 1911).

[16] See *e.g.*, *Dorland* v. *Fidelity Development Co.*, 104 Misc. 97, 99, 171 N.Y. Supp. 1000, 1001 (N.Y. Sup. Ct. 1918); *Skilton* v. *Cordington*, 185 N.Y. 80, 87, 77 N.E. 790, 792 (1906); *Hunting v. Blun*, 143 N.Y. 511, 38 N.E. 716 (1894); *Lang v. Lutz*, 180 N.Y. 254, 260, 73 N.E. 24, 26 (1905).

been entitled absent the abortive Chapter X proceeding, the holding below saddles the creditors with the burden of a reorganization instituted for the benefit of the debtor and its sole stockholder.

We note, in passing, the reliance placed by the majority below upon a number of cases in which the Interstate Commerce Commission and federal courts have approved plans of reorganization which contained provisions for the accrual of interest at the contract rate subsequent to the date of the reorganization petition. As the majority below concedes (R. 214-5), it does not appear that the question as to the proper rate of interest was ever raised or considered in those cases. The opinions and available financial manuals indicate that with one exception [17] those cases all involved claims whose normal maturity dates did not arrive until well after the petition for reorganization,[18] so that the equitable considerations for treating them as if reduced to judgment would appear to be lacking.[19] These cases, moreover, did not deny creditors the right to interest on a claim which was reducible to judgment at the date of the institution of Chapter X proceedings. In view of these circumstances, we do not believe that they are of any value as precedents in the instant controversy.

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[17] *In re Adolf Gobel, Inc.*, Bankruptcy No. 79,526, S.D. N.Y., plan approved June 1, 1944.

[18] Such were the facts in *Ecker* v. *Western Pacific R.R. Corp.*, 318 U.S. 448 (1943); *Brooks* v. *St. Louis-San Francisco Ry.*, 153 F. 2d 312 (C.C.A. 8, 1946), *cert. denied*, 328 U.S. 868 (1946); *Chicago, Rock Island & Pacific Railway Reorganization*, 254 I.C.C. 707 (1943); *In re McKesson & Robbins, Inc.*, 8 S.E.C. 853 (1941), cited by the court below.

[19] We do not urge that a claim which would normally mature after the Chapter X petition is entitled to judgment interest from the date of the petition. In our view, the contract interest governs to the date of normal maturity and, in the case of an undisputed claim, judgment interest thereafter. We do not argue for the allowance of judgment interest as of the date of an accelerated maturity caused by the institution of receivership or reorganization proceedings, since this acceleration may be regarded as a penalty which, under the *Vanston* case, should not be permitted to flow from the institution of such proceedings.

CONCLUSION

The petitions for certiorari should be granted.

Respectfully submitted,

ROGER S. FOSTER,
Solicitor, Securities and Exchange Commission

November, 1947.

Supreme Court of the United States

OCTOBER TERM, 1947.

Nos. 405, 406, 407.

IN THE MATTER

of

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

MANUFACTURERS TRUST COMPANY, Indenture Trustee,
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vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,
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EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,
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ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

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General Counsel, Reconstruction Finance Corporation, the holder of all the capital stock of the Respondent, Consolidated Realty Corporation.

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Cases Cited.

Other Authorities Cited.

Supreme Court of the United States

OCTOBER TERM, 1947.

Nos. 405, 406, 407.

IN THE MATTER

of

REALTY ASSOCIATES SECURITIES CORPORATION,

Debtor.

MANUFACTURERS TRUST COMPANY, Indenture Trustee,

Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

EDWIN B. MEREDITH, JACOB R. SCHIFF and MILTON C. ZAIDENBERG, as Members of the Bondholders' Protective Committee,

Petitioners,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

VANNECK REALTY CORPORATION,

Petitioner,

vs.

REALTY ASSOCIATES SECURITIES CORPORATION and CONSOLIDATED REALTY CORPORATION,

Respondents.

BRIEF IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

Statement by the Solicitor General.

The respondent Consolidated Realty Corporation is a corporation all of whose stock is owned by Reconstruction Finance Corporation. Consolidated, in turn, now owns all of the stock of Realty Associates Security Corporation.

The Securities and Exchange Commission is a statutory party to the case, pursuant to 11 U. S. C. Section 608. The Commission has taken a position contrary to that of the Reconstruction Finance Corporation. In view of the conflicting positions of the two governmental agencies, I am authorizing each to present a brief in its own name. *Cf. Consolidated Realty Corp.* v. *Meredith, et al.*, 323 U. S. 758.

PHILIP B. PERLMAN,
Solicitor General.

Preliminary Statement.

This brief is submitted on behalf of Realty Associates Securities Corporation (the Debtor) and Consolidated Realty Corporation (sole stockholder of the Debtor) in opposition to three petitions for writs of certiorari filed by the Bondholders' Protective Committee, Manufacturers Trust Company, and Vanneck Realty Corporation to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered on July 23, 1947. Such judgment modified an order of the United States District Court for the Eastern District of New York, entered on August 5, 1946 in the reorganization proceeding of the Debtor under Chapter X of the Bankruptcy Act.*

Opinions Below.

The opinion of the Circuit Court of Appeals (R. 209-219) is reported at 163 F. (2d) 387. The opinion of the District Court (R. 171-181) is reported at 66 F. Supp. 416.

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* The three petitions and briefs of the petitioners are referred to herein as "Committee Petition", "Manufacturers Petition" and "Vanneck Petition". The Securities and Exchange Commission has also filed a brief in this matter which is herein referred to as the "SEC Brief".

Jurisdiction.

The petitioners have invoked the jurisdiction of this Court under Section 24(c) of the Bankruptcy Act (11 U. S. C. §47(c)) and under Section 240(a) of the Judicial Code (28 U. S. C., §347(a)).

Statement of the Case.

On September 28, 1943, when the Debtor filed its petition for reorganization under Chapter X, the Debtor was not in default in any way. On the maturity date of its bonds (October 1, 1943) the stay provided pursuant to Chapter X suspended the Debtor's obligation of prompt payment of the principal of the bonds and of interest thereon which had accrued prior to the Chapter X petition but which did not become due until after the petition.

The Debtor remained in reorganization until April, 1945, when it became possible to pay its bondholders. At that time, the respondents did not deny that interest had continued to run on the Debtor's bonds during the period of the proceeding; the bondholders were paid all of the unpaid principal of their bonds, all of the unpaid pre-maturity interest which had become due during the proceeding, and interest at the 5% contract rate on the principal of the bonds for the entire post-maturity period down to the date of actual payment. The bondholders contended, however, that they were entitled to added compensation for the delay occasioned by the Chapter X proceeding; they claimed that they were entitled to the legal rate of interest, which is greater than the applicable contract rate, and to interest on the pre-maturity interest which became due and payable during the proceeding, but which was not paid on its due date because of the pending proceeding.

The respondents have contested the bondholders' asserted right to such added compensation.

Questions Presented.

The petitions present the following questions:

1. If bonds provide that interest shall be paid after their maturity date at the rate of 5% and the bonds mature during a Chapter X proceeding, is interest on such bonds after maturity to be computed at the 5% contract rate or the 6% legal rate?

2. If bonds contain no provision for the payment of interest on unpaid interest, and such bonds mature on a date during a Chapter X proceeding, at which maturity date all accumulated, accrued interest becomes payable, is interest payable on the accumulated interest from the date the accumulated interest was payable until it is paid?

The Court below held (1) that interest ran throughout the proceeding, both before and after maturity, at the 5% contract rate; and (2) that no interest was payable upon the accumulated interest which became due and payable during the Chapter X proceeding.

Reasons for Denying the Writs.

The respondents submit that, as to both questions, none of the petitions raises any question which warrants review by this Court, for the following reasons:

1. The sole basis for the petitioners' assertion that they are entitled to the legal rate of interest and to interest on interest is an alleged "judgment theory", which presents no problem of importance, because such theory is opposed by:

(a) The decision of this Court in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156 (1946), reh. den. 329 U. S. 833 (1947);

(b) The uniform practice of this Court and other federal courts in the computation of claims in Chapter X, Section 77B and Section 77 proceedings;

(c) The absence, not only of any conflict in the Circuit Courts of Appeal, but also of any bankruptcy, Chapter X, Section 77B or Section 77 case supporting the petitioners' "judgment theory";

(d) The purpose of Chapter X.

2. The petitions present no question regarding any provision of the Bankruptcy Act and the Circuit Court's decision is in complete harmony with the purpose of Chapter X.

3. The petitioners' assertion that the Court below has not properly construed the contract as to the post-maturity interest rate does not present a question of a character calling for decision by this Court.

Argument.

1. The "judgment theory" asserted by the petitioners raises no question for review by this Court.

The petitioners argue that, irrespective of the bondholders' rights under their contract, they had a right to the 6% legal rate after maturity both on the principal and on the accrued pre-maturity interest. The petitioners assert that there is a rule of law, applicable in Chapter X proceedings, which cuts across the provisions of the contract and entitles bondholders to the legal rate of interest after maturity (despite the contract specification of a lower rate) and also entitles them to interest on interest which became due during the proceeding but which was not paid on its due date.

The rule of law asserted by the petitioners is that an allowed creditor's claim in a Chapter X proceeding is, in effect, a "judgment" for the entire amount of the claim (*i.e.*, principal and all interest accrued before the Chapter X petition) which "judgment" bears interest at the legal rate from the date of the Chapter X petition or, in any case, from the date when the claim became payable by its terms. A variant of this theory is the petitioners' contention that the bondholders have sustained a "loss" as a result of the delay in collecting upon their bonds as each bondholder could, in the absence of the Chapter X proceeding, have obtained a judgment at maturity (October 1, 1943) for the principal amount of his bond and for all the accumulated interest which then became due. Each such judgment would have borne interest at the legal rate from the time it was entered and the bondholders assert that they are equitably entitled to be placed in as good a position as if the Chapter X proceeding had not stayed their immediate remedies.

The Court below decided that there is no such rule of law as the petitioners urge. Such decision is in accord with all of the pertinent decisions of this Court and the other federal courts and does not warrant review. There is no provision in Chapter X (or in any other part of the Bankruptcy Act) embodying such rule of law or in any way in conflict with the Circuit Court's decision. Not a single reorganization case has been cited by the petitioners in which the "judgment theory" has been adopted to produce the results they urge here. The uniform practice of the Courts, in computing claims in reorganization proceedings, stands opposed to the "judgment theory". And the recent decision of this Court in the *Vanston* case (*supra*, p. 4) is directly opposed to the petitioners.

A. The petitioners' "judgment theory" is directly opposed by this Court's decision in *Vanston Bondholders Protective Committee* v. *Green*.

The decision of this Court in *Vanston Bondholders Protective Committee* v. *Green* (*supra*, p. 4) is squarely opposed to the petitioners' "judgment theory" and leaves no question that a review of this case is unwarranted as to either the rate of interest question or the interest-on-interest question.

The facts of the *Vanston* case can be summarized as follows:

The equity receivership of Inland Gas Corporation began on December 2, 1930. No interest coupons on the Inland bonds were in default at that time, but default was later made in payment of the February 1, 1931 semi-annual interest coupon, which included interest accrued in respect of the four months before the start of the equity receivership. On April 3, 1931, the Indenture Trustee for the Inland bonds declared the entire principal immediately due and payable. In 1935 a creditors' petition for reorganization of Inland under Section 77B was approved, and at a later date the reorganization was continued as a Chapter X proceeding.

In 1938 the principal of the Inland bonds matured by their terms and remained unpaid. In 1943 a bondholders' committee petitioned for a cash distribution on the Inland bonds, and the Chapter X trustee asked the District Court whether the Inland bondholders were entitled to interest on their interest coupons from their due dates to the date of payment as expressly provided in the Inland indenture. The February 1, 1931 and all of the subsequently maturing interest coupons to and including the normal maturity date of the bonds in 1938 had remained unpaid. The security for the Inland bonds was adequate

to cover principal, the unpaid interest coupons, and interest on the principal and such coupons. It was conceded "that the first mortgage bondholders should receive simple interest on the principal due them", but there was a challenge to the Inland bondholders' "right to be paid interest on interest which fell due after the court took charge of Inland and which interest the Court * * * directed the receiver not to pay on the due date"*; as pointed out above, the interest on which interest was claimed included four months' interest which had accrued prior to the date of the equity receivership and several years' interest which had accrued and become payable prior to the Section 77B proceeding.

This Court (speaking through Mr. Justice Black) said that, when Inland went into receivership, the "obligation to make prompt payment of simple interest coupons was suspended," and pointed out that the "extra interest covenant may be deemed added compensation for the creditor, or, what is more likely, something like a penalty to induce prompt payment of simple interest."** This Court rejected the claim for interest on interest, holding that "legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay."***

The facts which were before this Court in the *Vanston* case are, in every material respect, identical with the facts in this *Realty Associates* case. The result in the *Vanston* case demonstrates that creditors are not entitled to be treated, under the circumstances of this *Realty Associates*

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* 329 U. S. at 159. The Record on Appeal in the *Vanston* case shows that the stay in the equity receivership was not materially different from the Chapter X stay in this *Realty Associates* case.

** 329 U. S. at 166.

*** 329 U. S. at 166-167.

case, as if they had obtained "judgments"; it demonstrates that the Court below was entirely correct in rejecting the petitioners' claim to such treatment. The holding in the *Vanston* case, although directed only to the interest-on-interest question, is equally opposed to the petitioners' contention that the allowance of a claim in a bankruptcy or Chapter X proceeding is a "judgment" for the purpose of raising the rate of interest.

If the petitioners' "judgment theory" were the law, the Inland bondholders would have been entitled to be treated as if they had obtained a "judgment" (for principal and all accrued interest) at the start of the equity receivership in 1930, or (if the "judgment theory" is mandatory under the Bankruptcy Act) at the start of the 77B proceeding in 1935. But the Inland bondholders were not treated as if they had obtained a judgment at either of these times. The petitioners' theory that a claim is "judgment" as of the date of the petition, when tested against the *Vanston* decision, is wrong.

But for the stay of the reorganization proceeding, the Inland bondholders could, at the normal maturity of their bonds in 1938, have sued for judgments for principal and all of the interest which had become payable between 1930 and 1938 and collected legal interest on such judgment. But this Court denied the Inland bondholders any interest at all on the long overdue interest. This Court refused to accord to the Inland bondholders any "judgment rights" either as of the date of the receivership or the Section 77B proceeding, or as of the "normal maturity" date of their bonds, which the petitioners in this *Realty Associates* case contend is required both by statute and judicial precedent.

The petitioners argue that this Court's refusal to give effect to a contract provision for the payment of interest on interest in the *Vanston* case warrants disregard of the

contract in this *Realty Associates* case. Their argument ignores the reasoning in the *Vanston* case. The reason that this Court refused to enforce a contract right to interest on interest was that the delay in payment was essential to administration of the debtor's estate for the benefit of all parties — secured creditors, unsecured creditors and the debtor. It is patent that this reason for disregarding a contract so as to deny interest on interest does not warrant the allowance of such interest when not contracted for or the increase of the contract rate of interest to the legal rate. Because the equitable powers of a Bankruptcy Court may be used to deny recognition of a right under a contract to "added compensation" does not mean that such powers are to be used to grant such a right when it does not exist either under the contract or applicable State law.

The petitioners assert that the *Vanston* case is distinguishable from this *Realty Associates* case because the former involved conflicting equities of two classes of creditors, whereas in this case the conflict is between creditors and the Debtor.* The *Vanston* opinion shows that such difference, if it existed, would be immaterial. The Inland bondholders' security was sufficient to pay them in full (including interest on interest) and they had undisputed priority over the subordinate creditors participating in the reorganization. The Inland bondholders were as fully entitled to "absolute priority" over the unsecured creditors in that proceeding as the *Realty Associates* bondholders are to "absolute priority" over the stockholders; the Inland bondholders had a right to be compensated for every cent of interest which was legally owing to them even if this left nothing for junior creditors. *Consolidated Rock Products Co.* v. *DuBois,* 312 U. S. 510, 527 (1941); *Group of Institu-*

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* SEC Brief, pp. 14-16; Committee Petition, p. 9; Manufacturers Petition 25, 34-35.

tional Investors v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U. S. 523, 546 (1943). Every equitable consideration in favor of a creditor against a stockholder is equally applicable in favor of a fully secured creditor against a junior creditor. And the *Vanston* decision shows that the "absolute priority" of senior parties over junior parties in a reorganization does not extend to "judgment rights".

Further, the denial of the petition for rehearing by this Court in the *Vanston* case shows that the factual distinction which the petitioners assert does not exist. It was pointed out to the Court in such petition that the facts warranted the conclusion "that there are now assets sufficient, if its [the Court's] decision stands, to make a payment on the stock of the Debtor".* Despite such a showing, this Court denied the petition for rehearing, confirming the conclusion to be derived from its original opinion that it did not intend to limit the denial of interest-on-interest to cases involving insolvent debtors.

The petitioners also try to escape the rule of the *Vanston* case on the ground that the interest on which interest was sought had accrued in the *Vanston* case during the reorganization proceeding, whereas substantially all the interest in this *Realty Associates* case accrued (although it did not become due) prior to the reorganization proceeding.** But as pointed out above (pp. 7-8), a large part of the interest in the *Vanston* case had accrued and become payable prior to the statutory reorganization proceeding under Section 77B and Chapter X; and four months' interest represented by the February 1, 1931 coupon accrued prior to

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* Page 3 of the Petition for Rehearing in the *Vanston* case filed January 3, 1947.

** SEC Brief, pp. 14-16; Committee Petition, p. 9; Manufacturers Petition, p. 13.

the original equity receivership although such interest, like the accumulated interest in this *Realty Associates* case, did not become payable until after the proceeding had started.

Further, the petitioners' argument ignores the reasoning of this Court in the *Vanston* case which demonstrates that the crux of the matter is not the period in respect of which the interest accrued, but the time when it fell due and the reason it was not paid when due. If the reason was that a Chapter X proceeding was pending (legally suspending payment of the interest on the due date), then, under the *Vanston* case, interest is not allowed for the delay in the payment. That was true in the *Vanston* case and is equally true in this *Realty Associates* case.

The petitioners also assert this *Realty Associates* case differs from the *Vanston* case because the Chapter X petition here was a voluntary petition.* This attempted distinction, too, is without validity. Chapter X was made available by Congress to petitioning debtors as well as petitioning creditors. To hold that one rule of law is applicable if the petition is voluntary, and another rule if involuntary, would be unworkable and would negate the very purpose of Congress in permitting debtors to apply for relief.

The scope of the *Vanston* rule is shown by this Court's later decision in *Fleming* v. *Traphagen*, 329 U. S. 686 (1946) reh. den. 329 U. S. 832 (1947), in which the Court, on the authority of the *Vanston* case, reversed a holding of the Circuit Court of Appeals for the Seventh Circuit which had allowed interest upon interest.** The bonds in the *Fleming* case were fully secured; the income from the division of the debtor railroad securing the bonds exceeded the amount required for the payment of interest during the extended

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* Committee Petition, p. 9; Manufacturers Petition, p. 52.

** 155 F. (2d) 889 (C. C. A. 7th 1946).

period of delay caused by the Section 77 proceeding; and the Circuit Court of Appeals had held that the applicable State law entitled the bondholders to interest on interest. This Court nevertheless reversed the lower court's allowance of such interest.

The respondents submit that the *Vanston* case is decisive of both of the questions here presented; that the rejection of the "judgment theory" by the court below was the only possible result consistent with the *Vanston* case; and that there is accordingly no occasion for the writs to issue.

B. The uniform practice of the courts, in computing claims in reorganization proceedings, is opposed to the "judgment theory".

In case after case, the District Courts, the Circuit Courts of Appeal and this Court, in computing the amount of creditors' claims to be paid or provided for in Chapter X and railroad reorganization plans, have proceeded in direct conflict with the petitioners' "judgment theory".

(i) Cases Relating to the Rate of Interest.

Before discussing the reorganization cases, the respondents wish to point out that the petitioners and the SEC are in error in assuming that their "judgment theory" is followed in straight bankruptcy. By making this assumption the petitioners are able to frame a question-begging issue for this Court of whether creditors' rights are less under Chapter X than in straight bankruptcy.* But the courts have not—even in straight bankruptcy— followed the "judgment theory" asserted by the petitioners.

The bankruptcy courts have, for example, in those cases in which interest after the petition was payable, given effect

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* SEC Brief, pp. 2, 7-12; Committee Petition, pp. 8, 16; Manufacturers Petition, p. 10; Vanneck Petition, p. 4.

to the contract as to the rate of interest payable for the period of the bankruptcy proceeding. In one of the principal bankruptcy cases establishing the doctrine that interest is to be paid on principal where a secured creditor's security is sufficient (or where the bankrupt is solvent), *Coder* v. *Arts*, 213 U. S. 223, 245 (1909), this Court affirmed a decision which had allowed the payment of interest during the period of bankruptcy at the contract rate "*in accordance with the terms of the note and mortgage*".* See also 3 COLLIER, BANKRUPTCY (14th ed. 1941), pp. 1839, 1844, to the effect that, if a bankrupt proves to be solvent, interest will be allowed during the proceeding "*at the rate contracted for*" up to the date of payment. The petitioners' contention that the Circuit Court's decision in this *Realty Associates* case gives creditors "less substantive rights" in Chapter X than in straight bankruptcy is thus demonstrably incorrect as to the rate of interest point.

The Circuit Court, however, limited its rejection of the petitioners' "judgment theory" to reorganization cases (reserving decision on whether the "judgment theory" would warrant departure from the contract rate of interest in a straight bankruptcy case); as shown below, the reorganization precedents are uniformly consistent with the decision of the Circuit Court.

In the Section 77 case of *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448 (1943), the computation of the claims set forth in the opinion of this Court demonstrates that claims are not treated as "judgments", but are to be computed (with respect to the period after, as well as before, the reorganization petition) in accordance with the provisions of the contract.

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* *Coder* v. *Arts*, 152 Fed. 943, at 950 (C. C. A. 8th 1907). Emphasis supplied throughout this brief, unless otherwise noted.

The *Western Pacific* reorganization began with the filing of the debtor's petition on August 2, 1935. Interest installments on the Western Pacific's First Mortgage Bonds had matured and remained unpaid for almost a year and a half before the start of the proceeding. If there were any validity to the "judgment theory", then the First Mortgage Bondholders should have been allowed interest after the date of the petition at the legal rate, and such allowance should have included legal interest not only on the principal, but also on all of the accrued interest which was due and unpaid at the date of the petition. But this was not done. Instead, the First Mortgage Bondholders' claim was allowed for the principal amount of the bonds plus "Accrued interest at contract rate to effective date of plan" on principal only (318 U. S. 448, at p. 455). Thus the interest was computed at the 5% rate provided for in the contract; it was not computed at the 6% legal rate which would have had to be applied if there were any such rule of law as the "judgment theory".

In *Brooks* v. *St. Louis-San Francisco Railway Co.*, 153 Fed. (2d) 312 (C. C. A. 8th 1946) cert. den. 328 U. S. 867 (1946), the argument was advanced to the Court that certain secured bondholders were not entitled to any interest from the time of the initiation of the reorganization proceedings. The Court quite properly held that the bondholders were entitled to such interest as a matter of right and that the rate of interest to which they were entitled was the contract rate. The Court said (p. 318):

> "Interest on secured claims to the effective date of the plan is entitled to the same priority as the principal. *Consolidated Rock Products Co.* v. *DuBois, supra; Ecker* v. *Western Pacific R. Corporation, supra; Case* v. *Los Angeles Lumber Products Co., supra; Louisville Joint Stock Land Bank* v. *Radford,*

> 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106; *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Railway,* 233 U. S. 261, 34 S. Ct. 502, 58 L. Ed. 949; *Group of Investors* v. *Milwaukee R. Co., supra.* The time as of which the claims of creditors should be computed was fixed as January 1, 1944 [the effective date of the plan of reorganization]. From that time the interest on the securities will be the new rate, *but up to that time it will be computed on the old securities at the contract rate.* This determination, we think, is reasonable and equitable and violative of no legal principle."

As shown in the appendix to this brief, in the computation of claims in numerous other railroad reorganizations in which various bond issues matured during the proceedings, the interest that was allowed for the period of the proceedings, both before and after the maturity of the bonds, was at the contract rate. *Chicago, Rock Island & Pacific Railway Reorganization,* 257 I. C. C. 307 (1944); 157 F. (2d) 241 (C. C. A. 7th 1946); *Missouri Pacific Railroad Reorganization,* 257 I. C. C. 479 (1944); 64 F. Supp. 64 (E. D. Mo. 1945); *Minneapolis, St. Paul & Sault Ste. Marie Railway Company Reorganization,* 252 I. C. C. 525 (1942); 48 F. Supp. 330 (Minn. 1942); *Chicago, Milwaukee, St. Paul & Pacific Railroad Company Reorganization,* 254 I. C. C. 707 (1943); 145 Fed. (2d) 299 (C. C. A. 7th 1944).

This same practice has also been followed in Chapter X proceedings. For example, this was done in the reorganization proceeding relating to *McKesson & Robbins, Inc.* in the Southern District of New York. The computation of claims in this proceeding is shown by the report of the SEC on the proposed plan of reorganization* and the SEC took a position there totally inconsistent with the

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* 8 S. E. C. 853 (1941).

"judgment theory" as it approved of a plan that provided for the contract, not the legal rate of interest. The SEC said in its report (8 S. E. C. 853 at 876):

> "The plan provides that creditors shall receive all accrued interest in cash. The rate of interest on the several claims is the legal rate *where there is no contract rate.* Thus, with respect to the debentures (item 2) interest on principal and on overdue installments of interest is computed at the rate of 5½% *in accordance with the provisions of the indenture under which the debentures were issued.*"*

Another Chapter X example is *In re Adolf Gobel, Inc.* (Bankruptcy No. 79,526, S. D. N. Y., 1944), the relevant facts being set forth in the appendix to this brief; the plan, as approved and confirmed, provided for continuation of the 4½% contract rate of interest on debentures throughout the proceeding although the bonds had matured by their terms prior to the start of the proceeding.

The significance of this continued recognition of the contract rate of interest in these reorganization cases is clear. Allowed claims of senior creditors must include all interest to which they are entitled down to the effective date of the plan of reorganization if any junior interests are allowed to participate; otherwise the treatment accorded such senior creditors is not "fair and equitable." *Consolidated Rock Products Co.* v. *DuBois* (*supra*, p. 10); *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co.* (*supra*, pp. 10-11). If there were a rule of law such as the "judgment theory" entitling bondholders, irrespective of the provisions of their contract, to the legal rate

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* As the *McKesson* reorganization was consummated before this Court's decision in the *Vanston* case, an express contractual provision for interest on interest was given effect in accordance with the SEC's recommendation.

of interest from the date of the petition (or from the maturity of their bonds) then the reorganization plans in all of the above-discussed cases would, to the extent that junior interests were allowed to participate, violate the "absolute priority" rule as set out in the *Consolidated Rock Products* and *Milwaukee* cases. That the reorganization plans in these cases have been held to be "fair and equitable" demonstrates the absence of any rule of law such as the "judgment theory" which would entitle senior creditors to greater rights than they were accorded.

The petitioners and the SEC seek to avoid conflict with the above cited precedents and to justify their position in this *Realty Associates* case by saying that they would apply the "judgment theory" to change from the contract rate to the legal rate only as at the "normal" maturity date of the bonds and suggest that judgment rights in this respect are not to be extended to a creditor if his claim does not reach "normal" maturity during the pendency of the proceeding; in such case the petitioners and the SEC would give the creditor only contract interest throughout the proceeding.* The petitioners thus concede (after considerable argument that the "judgment" rights of creditors stem from Section 63(a)(1) of Bankruptcy Act "at the date of the petition"**) that the Act itself does not give a creditor "judgment rights" to the legal rate. The petitioners necessarily abandon their position that the statute makes "judgment rights" mandatory when they take the totally inconsistent position that there are no such rights until "normal maturity". And the petitioners ignore that, in the *Gobel* case (*supra*, p. 17), the bonds matured before the proceeding and in *Coder* v. *Arts* (*supra*, p. 14), and in

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* SEC Brief, p. 17, n. 19; Manufacturers Petition, p. 40n.; Vanneck Petition, pp. 6-7.

** SEC Brief, pp. 8-14.

the *Rock Island, Missouri Pacific, Minneapolis-St. Paul* and *Milwaukee* cases (*supra*, p. 16) the claims reached their "normal maturity date" during the proceedings and that the contract rates of interest were nevertheless applied to the period after maturity as well as before.

The SEC attempts to escape this dilemma by saying that some of the cases cited above involve claims whose "normal" maturity dates did not arrive until "well after" the petition for reorganization;* while the petitioners suggest that in this *Realty Associates* case the three-day interval between the filing of the petition and the due date of both the principal and the interest on the bonds is "inconsequential".** But Chapter X permits the filing of a petition in contemplation of an approaching maturity, and complete uncertainty would be introduced into Chapter X proceedings if the change from the contract rate to the legal rate were made dependent upon the length of the interval between the date of the petition and the maturity of the debt.

(ii) Cases Relating to Interest on Interest.

Despite the petitioners' assertions that their "judgment theory" is a well-established rule, they have not cited a single case under Chapter X or Section 77 or Section 77B requiring the payment of interest on interest accrued to or payable at the date of the petition. In fact, quite apart from the *Vanston* case, which is a square holding against the allowance of interest on interest in a Chapter X proceeding, the reorganization cases have not allowed interest on interest where, as here, there was no contract right to it. This Court, in *Ecker* v. *Western Pacific Railroad Corp.*, referred to above (pp. 14-15), had before it a claim which

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* SEC Brief, p. 17.

** Committee Petition, p. 4.

included bond interest installments matured and payable prior to the inception of the reorganization proceeding. The computation of the bondholders' claim did not include any interest on such interest.

In both the *Chicago, Rock Island and Pacific Railway Reorganization* (*supra,* p. 16), and the *Missouri Pacific Railroad Reorganization* (*supra,* p. 16), the bond issues matured during the proceeding and interest was in default for a period of years before the maturity date of the principal. In the computation of the claims of the holders of these bonds, no interest was allowed on such interest.* And in *In re Norcor Mfg. Co.,* 36 F. Supp. 978 (E. D. Wis. 1941) and *In re Wisconsin Central Railway Co.,* 63 F. Supp. 151 (D. Minn. 1945) creditors' claims for interest on interest were also denied. The same result was reached in *In re Adolf Gobel, Inc.* (Bankruptcy No. 79,526, S. D. N. Y. 1944).*

C. The cases cited by the petitioners do not support their theory and there is no conflict in any of the Circuit Courts of Appeals.

The cases cited by the petitioners do not support their theory. The Circuit Court (R. 214) rejected the application which the petitioners would make of *In re John Osborn's Sons & Co.,* 177 Fed. 184 (C. C. A. 2d 1910).** In the *Osborn* case, the Circuit Court did not have before it, as it did here, a case in which the application of the "judgment theory" would change the rate of interest from that provided for by the parties' agreement; and the *Osborn* case did not involve any question of interest on interest.

The SEC and the petitioners give the impression that in *Johnson* v. *Norris,* 190 Fed. 459 (C. C. A. 5th 1911) interest

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* Data showing the computation of claims in these cases is set forth in the appendix to this brief.

** Committee Petition, p. 16; Manufacturers Petition, p. 19; Vanneck Petition, p. 10; SEC Brief, p. 8.

was allowed on interest.* But this is not so. A study of the record of that case shows that the problem of interest on interest was not before the Court.** And a study of the opinion shows that, although the "judgment theory" was argued and the Court's attention was directed to the *Osborn* case and *National Bank of the Commonwealth* v. *Mechanics' National Bank*, 94 U. S. 437 (1876), the Court refused to base the allowance of simple interest on principal on any ground so mechanical as the "judgment theory", but instead based the allowance upon its general equitable powers. The Court also noted, contrary to the petitioners' position here, that there was nothing in the Bankruptcy Act relating to the problem of post-petition interest in bankruptcy proceedings. Thus, *Johnson* v. *Norris* does not present a "conflict" with the decision below, as contended by one of the petitioners***, but, like the decision below, actually rejected the "judgment theory".

The facts in the *Mechanics' National Bank* case (*supra*) make it apparent that it has no application to the *Realty*

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* The SEC Brief says (p. 9): "Thus, in *Johnson* v. *Norris*, 190 Fed. 459 (1911), the Fifth Circuit Court of Appeals ruled that interest was payable on claims which, as filed, included interest accrued prior to the date of the bankruptcy petition, before any part of a surplus held by the trustee could be turned over to the bankrupt."

** At page 10 of the Record on Appeal in *Johnson* v. *Norris* the question which had been certified by the Referee and which was before the Circuit Court is set forth as follows:

> "Are creditors who have been paid in full *the amount of claims* filed against the bankrupt estate, *together with interest thereon up to the date of the filing of the petition in bankruptcy*, also entitled to collect out of said estate *interest on their claims* from the date of the filing of the petition in said bankruptcy up to the time of payment in full of said claims?"

The language in the quotation shows that the word "claims" referred only to the principal of the debt and that the interest thereon prior to the date of the petition in bankruptcy was not included in the term.

*** Manufacturers Petition, pp. 30-31.

Associates situation. In the *Mechanics'* case, certain bank depositors demanded payment of their deposits on September 24, 1873, but the bank failed to pay. On November 22, 1873, the Comptroller of Currency appointed a receiver for the bank and such receiver made four different payments on account of principal owed to the bank's depositors. At the time of each such principal payment, demand was made by the depositors for the payment of interest thereon from September 24, 1873. Each of the four demands for interest was rejected by the receiver, the final rejection being at the time of the final principal payment on November 20, 1874. Suit was then brought by the depositors for the aggregate of all rejected interest claims and interest thereon from November 20, 1874, the date of the final rejection, and that is what the Court allowed. The Court did not treat the claimants as judgment creditors as of the start of the receivership, but held that the final rejection of the claims could, under those facts, be treated as a judgment.

The *Mechanics'* case would be apposite in this *Realty Associates* case only if District Judge Moscowitz, in computing the bondholders' claims in his order of April 2, 1945, dismissing the proceeding, had denied to the bondholders any interest on the principal of their bonds after maturity. If Judge Moscowitz had made such a determination, it would have been error, the reversal of which would have justified the reviewing court, on the authority of the *Mechanics'* case, in instructing the payment not only of the interest on principal which accrued during the proceeding, but also interest on that interest from and after April 2, 1945.

In re New York, New Haven & Hartford R. Co., 147 F. (2d) 40 (C. C. A. 2d 1945), cited by the petitioners,* in

* SEC Brief, pp. 15-16; Vanneck Petition, p. 9.

no way supports them. The question there presented was whether creditors who were almost fully secured at the start of the proceeding, but whose security became worthless during the Section 77 restraint on foreclosure, should be treated as unsecured creditors. As shown below (p. 27) the Realty Associates bondholders, unlike the *New Haven* secured creditors, have not in fact sustained any loss as a result of the proceeding; further, the application which the petitioners would make of the *New Haven* case would be in conflict with the *Vanston* case.

The other cases cited by the petitioners and the SEC are likewise inapposite. For example, *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (C. C. A. 3rd 1917)—cited in the Manufacturers Petition (p. 32) as presenting a "conflict" with the decision below—dealt only with the right of a mortgagee to have rents from property subject to the mortgage applied to the mortgage debt as against the claims of the bankrupt's general creditors. The case had nothing to do with any problem of the computation of interest.*

The petitioners and the SEC have not cited a single Chapter X, Section 77B, Section 77 or bankruptcy case in which the "judgment theory" or any other theory was given effect to apply the legal rate to the post-petition or post-maturity period in disregard of the applicable contract rate; and not one of their briefs refers to a single Circuit Court Chapter X, Section 77B, Section 77 or bankruptcy case which allowed interest on interest.**

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* The same is true of the other cases cited in the SEC Brief (p. 16, footnote 15) with the *Bindseil* case.

** Manufacturers Petition (pp. 12-13, 22n.) cites as authority for allowing interest on interest two recent unreported decisions in Chapter X proceedings in the Southern District of New York relating to *Childs Company* and *United States Realty & Improvement Company* (in neither of which there was an opinion). It is sufficient to say here that both such decisions were made prior to this Court's decision in the *Vanston* case.

D. The construction of the Bankruptcy Act is not involved and the "judgment theory" is contrary to the purpose of Chapter X.

Some of the petitioners urge that a construction of the Bankruptcy Act is involved and suggest that support for their view is to be found in Section 63(a)(1) of the Bankruptcy Act.* But it is this very section of the Bankruptcy Act which expressly cuts off the accrual of interest in bankruptcy at the date of the bankruptcy petition so that no interest runs during the proceeding.** So far as Section 63(a)(1) is concerned, interest stops as of the date of the petition; the bondholders cannot obtain any authority for their position from its provisions. In cases in which the bankrupt or debtor is solvent (or a secured creditor's security is sufficient) the courts have held that the obligation to pay interest "revives" (See 3 COLLIER, BANKRUPTCY, 14th Ed., p. 1838) and that interest runs on principal during the proceeding, but this is an equitable rule developed by the courts; it is not based on statute. Neither Section 63(a)(1) nor any other section is involved in the questions here presented.

The suggestion in the SEC Brief (p. 11) that the decision below creates problems under Section 238 (1) in the event that a Chapter X proceeding is converted into a straight bankruptcy liquidation is negated for two reasons: first, the SEC assumes, mistakenly as shown above (pp. 13-14), that in straight bankruptcy the bondholders would have been entitled under the "judgment theory" to the legal rate of interest and to interest on interest; second, conversions from Chapter X to straight bankruptcy occur in cases in which the debtor is insolvent and, in such cases,

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* 11 U. S. C. §103(a)(1).

** *Sexton* v. *Dreyfus*, 219 U. S. 339 (1911); 3 COLLIER, BANKRUPTCY (14th ed. 1941) p. 1835, *et seq.*

the creditors are denied, not only "judgment interest", but any post-petition interest at all. If the debtor is solvent or if secured claims are involved, the computation of interest, under the principles so recently reviewed by this Court in the *Vanston* case, would hardly present "difficulties" such as the SEC fears.

The application of petitioners' "judgment theory" would, moreover, contravene the purpose of Chapter X, which contemplates a continuation of the business of the debtor, a continuation of the contractual relationships between the debtor and its creditors, and a stay of the normal creditors' remedies until a plan of reorganization is evolved which is fair to all interested parties. As was aptly said by the SEC itself several years ago:*

> "Reorganization is not bankruptcy and becomes such only if an order of liquidation is entered. The estate is not a 'dead fund'; its status as a going concern is maintained until a plan of reorganization can be worked out. We submit that while the business continues as a living enterprise, substantial justice can be worked only by a rule which continues the contract rights of the parties so far as possible as they existed before the enterprise came under judicial control; that is, by the accrual of interest on the debts until the cut-off date under the plan."

To apply the "judgment theory" so as to disregard the contract between the debtor and its creditors and arbitrarily allow interest at the legal rate from the date of a Chapter X petition (or from the maturity date of bonds) and to allow interest on interest would be to deny to debtors the relief that Congress provided for them in Chapter X.

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* In the "Memorandum of the Securities and Exchange Commission, Supplementing its Advisory Report, in Support of Accrual of Interest During Reorganization Proceedings," which the SEC submitted to the Court in a Chapter X proceeding, *In re Minnesota and Ontario Paper Company*, 7 S. E. C. 456 (1940); S. E. C. Corporate Reorganization Release No. 33 (pp. 8-9) (August 1, 1940).

Interest upon a judgment is allowed as damages for unwarranted delay in payment. But Congress, by enacting Chapter X, has expressly authorized delay in the payment of a debt in certain cases—cases in which a petition is filed, in good faith, by a debtor unable to meet its debts as they mature. Such delay is authorized for the benefit and protection of creditors as well as the debtor, for all creditors might suffer if they were free to obtain judgments, levy executions and force the immediate sale of a debtor's assets at depressed values. Congress recognized that the interests of creditors and the debtor lay in the preservation of the business as a going concern and the orderly adjustment of the claims of creditors under the supervision of the Court in accordance with the principles laid down in the statute.

The bondholders in this *Realty Associates* case were stayed from bringing suit at the maturity of their bonds and thus forcing an immediate liquidation. But the necessity for such a stay, if the bondholders were to be paid in full and the purpose for which Congress enacted Chapter X thus achieved, is shown by the following statement of the District Court (in its unreported opinion deciding that the petition in this *Realty Associates* case was filed in good faith):

> "Now, of course, if this were not a procedure under Chapter X, if it went into bankruptcy and judgments piled up against the debtor on these bonds that become due on October 1st, and with the debtor here a straight bankrupt, it would wipe out these assets and the creditors would probably realize very little. It would be calamitous—yes, calamitous unless this corporation and the creditors who came first were afforded protection under the law, and I can think of no greater disservice by court or by counsel to creditors than not to give them the protection and benefit of this law."

Statements in the SEC Brief (pp. 3 and 16) regarding the Debtor's Chapter X petition give an erroneous impression that the Debtor sought relief under Chapter X solely to protect itself. As the petition shows, relief was sought "for the protection of creditors and stockholders" (R. 6-7) and, as the District Judge found when ruling upon the petition, the proceeding was filed in good faith and was necessary for the protection of creditors as well as the Debtor.

The bondholders were not damaged by the proceedings thus instituted for the benefit of all; under Chapter X, they realized their full claim with interest on principal to the date of payment, a result which (as pointed out by the District Court) would have been unlikely if the bondholders had been allowed to sue for and enforce judgments at the maturity of the bonds. Contrary to one petitioner's assertion that the Debtor realized "vast income" during the proceedings,* the earnings of the Debtor during the entire period of the Chapter X proceedings amounted to $302,216.35 (R. 144)—less than enough to pay the 5% contract rate of interest on principal which was paid to the bondholders. To now treat the bondholders as "judgment creditors" from the date of the petition (or from the maturity date of their bonds) so that they can obtain added compensation for the delay would be inconsistent with the provisions of Chapter X which authorized the delay for the benefit of all concerned.

Both the theory of Chapter X and the realties of this case dispose of the petitioners' argument that the bondholders have sustained any loss of "substantive rights" as a result of the decision below.

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* Manufacturers Petition, p. 4.

2. The construction of the contract by the Court below does not warrant review.

The Court below, having rejected the "judgment theory", held that the contract rate of interest ran during the proceedings and found that the contract here involved, when construed under the applicable New York law, provided for an interest rate of 5% after maturity. Such a decision does not call for review by this Court.

Article VI of the Debtor's 1933 Indenture provides that, upon the happening of various events of default (including the start of insolvency proceedings or non-payment at maturity) the moneys recovered by the Indenture Trustee in legal proceedings shall be applied to payment of principal and interest, "*with interest at the rate of five per cent. (5%) per annum on the overdue principal*" (R. 120). This provision leaves no doubt that the parties intended that the 5% rate should apply after a defaulted maturity date. The Circuit Court thus gave the contract the only construction which would be consistent with the intention of the parties.

The bondholders' contract with the Debtor does not provide for the payment of interest on interest; neither the 1933 Indenture nor the bonds provide for such payment. Thus the decision below is entirely consistent with the views expressed in the concurring opinion written by Mr. Justice Frankfurter in the *Vanston* case, as well as with the majority opinion in that case.

Even if the bondholders' contract expressly provided for interest on interest, it would appear from the applicable New York cases that the bondholders could not recover interest upon interest. The New York cases hold that, as a matter of law, interest is not payable upon interest.

Young v. *Hill*, 67 N. Y. 162 (1876); *Newburger-Morris Co.* v. *Talcott*, 219 N. Y. 505, 114 N. E. 846 (1916); *Continental Securities Company* v. *New York Central & H. R. R.*, 217 N. Y. 119, 111 N. E. 484 (1916); *Transbel Investment Co.* v. *Roth*, 36 F. Supp. 396 (S. D. N. Y., 1940).*

The opinion of the Court below shows, however, that its decision was not based on this New York policy against interest on interest as suggested by the SEC.** The Court rejected the claim to interest on interest on the authority of the *Vanston* case (R. 217), which is applicable with even greater force to the *Realty Associates* bonds which did not provide for interest on interest.

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* There is an exception, not material here, to such rule. If interest coupons have been negotiated separately from the bonds, interest on such coupons may be recovered. *Williamsburgh Savings Bank* v. *Solon*, 136 N. Y. 465, 32 N. E. 1058 (1893); *Long Island L. & T. Co.* v. *Long Island City & N. R. R. Co.*, 85 App. Div. 36 (2d Dept. 1903), aff'd 178 N. Y. 588 (1904).

** SEC Brief, p. 14.

Conclusion.

Each of the petitions for a writ of certiorari should be denied.

Dated, November 17, 1947.

Respectfully submitted,

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Appendix.

Data Showing Computation of Claims in Various Reorganization Cases Cited in the Foregoing Brief (pp. 16-17, 20).

1. *Chicago, Rock Island & Pacific Railway Company Reorganization,* 257 I. C. C. 307 (1944). The plan was approved by a District Court in 1945 and such approval was affirmed in 157 F. (2d) 241 (C. C. A. 7th, 1946). The reorganization petition was filed on June 7, 1933 and the effective date of the plan was January 1, 1944.

   (a) The claim of holders of *Rock Island, Arkansas & Louisiana First Mortgage 4½s, due 1934* was computed as follows:*

(i) Total claim of bondholders for principal (257 I. C. C. 318).....	$11,000,000
(ii) Total claim of bondholders allowed for interest (257 I. C. C. 339)	5,362,500
(iii) Total claim of bondholders for principal and interest as of January 1, 1944 (257 I. C. C. 318)....	$16,362,500

Interest was owing on these bonds from March 1, 1933 (see Moody's *Railroads,* 1943, p. 519) down to January 1, 1944 (the effective date of the plan), which is a period of 10 years and 10 months. 4½% interest on the $11,000,000 principal for 10 years and 10 months is precisely the amount of interest allowed in the claim..... $ 5,362,500

* The claim in this *Rock Island* proceeding of the holders of *The Chicago, Rock Island & Pacific First and Refunding Mortgage 4% bonds due 1934* was computed in the same manner as this issue (see 257 I. C. C. 318, 338). Details as to such claim are not given as they would merely be cumulative.

(b) The claim of holders of *Burlington, Cedar Rapids & Northern Consolidated First Mortgage 5s, due 1934* was computed as follows:

(i) Total claim of bondholders for principal (257 I. C. C. 318).....	$11,000,000
(ii) Total claim of bondholders allowed for interest (257 I. C. C. 339)	5,912,500
(iii) Total claim of bondholders for principal and interest as of January 1, 1944 (257 I. C. C. 318)....	$16,912,500
Interest was owing on these bonds from April 1, 1933 (see Moody's *Railroads,* 1943, p. 513) down to January 1, 1944 (the effective date of the plan), which is a period of 10 years and 9 months. 5% interest on the $11,000,000 principal for 10 years and 9 months is precisely the amount of interest allowed in the claim.....	$ 5,912,500

2. *Missouri Pacific Railroad Reorganization,* 257 I. C. C. 479 (1944). The plan was approved by the District Court in 64 F. Supp. 64 (E. D. Mo. 1945). The reorganization petition was filed in 1933 and the effective date of the plan was January 1, 1943.

The holder of each $1000 *Little Rock & Hot Springs Western First 4% Bond* which matured in 1939 was allowed for his interest claim (257 I. C. C. 569).....	$ 320
Interest was owing on these bonds from January 1, 1935 (see Moody's *Railroads,* 1944, p. 948) down to January 1, 1943 (the effective date of the plan)—a period of 8 years. Interest at the rate of 4% on $1000 for 8 years is	$ 320

3. *Minneapolis, St. Paul & Sault Ste. Marie Railway Company Reorganization,* 252 I. C. C. 525 (1942). The plan

was approved by the District Court in 1942, 48 F. Supp. 330 (Minn., 1942). The petition was filed in 1937 and the effective date of the plan was January 1, 1941.

The table of claims (252 I. C. C. 581) shows that the interest rates specified in the bonds were used in computing the "Amount of claim and interest to January 1, 1941" (the effective date of the plan). This is easily demonstrated by considering in such table the claim of the unguaranteed *First Consolidated Mortgage 5% Bonds* which matured on July 1, 1938:*

Principal of claim	$ 6,148,000
"Interest matured Jan. 1, 1938, to Jan. 1, 1941 inclusive" allowed in the claim	$ 1,075,900

It can be seen that the interest in the claim was for a period of 3½ years (the Jan. 1, 1938 coupon covered the 6 months back to July 1, 1937). One year of this 3½ years was prior to the maturity of the bonds and 2½ years were after maturity. 5% interest on the $6,148,000 principal for 3½ years is precisely the amount of interest allowed in the claim $ 1,075,900

4. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company Reorganization,* 254 I. C. C. 707 (1943). Approved 58 F. Supp. 384 (N. D. Ill., 1944), appeals dismissed 145 F. (2d) 299 (C. C. A. 7th, 1944). The petition was filed in 1935 and the effective date of the plan was January 1, 1944.

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* As recited in the table, the contract rates of interest (4% as to some bonds and 5% as to others) were also used in computing the claim of the First Consolidated Mortgage bonds which were guaranteed as to interest by the Canadian Pacific Railway. Because of certain minor adjustments not here material, calculation of the interest on these bonds cannot be made solely from the figures furnished in the table at 352 I. C. C. 581.

(a) The claim of the holders of *Milwaukee & Northern First 4½% Bonds* which matured in 1939 was computed as follows:

(i) Total claim of bondholders for principal (254 I. C. C. 739).....	$ 2,117,000
(ii) Total claim of bondholders allowed interest from January 1, 1939 to January 1, 1944 (254 I. C. C. 713).....	$ 476,325
Interest was owing on these bonds from January 1, 1939 to January 1, 1944 (the effective date of the plan), which is a period of 5 years. 4½% interest on the $2,117,000 principal for 5 years is precisely the amount of interest allowed in the claim*.....	$ 476,325

(b) The claim of the holders of *Milwaukee & Northern Consolidated 4½% Bonds* which matured in 1939 was computed as follows:

(i) Total claim of bondholders for principal (254 I. C. C. 739).....	$ 5,072,000
(ii) Total claim of bondholders allowed for interest from January 1, 1939 to January 1, 1944 (254 I. C. C. 713).....	$ 1,141,200
Interest was owing on these bonds from January 1, 1939 to January 1, 1944 (the effective date of the plan), which is a period of 5 years. 4½% interest on the $5,072,000 principal for 5 years is precisely the amount of interest allowed in the claim*.....	$ 1,141,200

* See, also, 254 I. C. C. 707, at p. 712, where the Commission says that the interest on these bonds for the period from January 1, 1939 to January 1, 1944 was to be paid in cash "*at the rates named in the bonds*".

5. *In re Adolf Gobel, Inc.* (Bankruptcy No. 79,526, S. D. N. Y.; plan approved on June 1, 1944 and confirmed on July 31, 1944, by Judge Coxe). The Chapter X petition was filed on September 29, 1941 and the effective date of the plan of reorganization was October 16, 1944.

The debtor had outstanding $1,081,000 principal amount of 4½% Convertible Debentures which had matured in normal course on May 1, 1941 (before the start of the Chapter X proceeding). At the start of the proceeding, interest for the five months' period after the maturity of the Debentures was also unpaid. The common stockholders' participation in the debtor was continued (without their putting up any funds). Public bondholders holding $358,000 principal amount of the Debentures, were paid in cash under the reorganization plan "the principal amount of the $358,000 of Old Debentures * * * with interest on said principal at the rate of 4½% per annum from May 1, 1941 to October 16, 1944." (See Judge Coxe's Order in Aid of Consummation of the Plan of Reorganization dated October 6, 1944, in the Court file in the proceeding.)*

* The remaining $723,000 principal amount of Debentures plus interest at 4½% to October 16, 1944 were surrendered for new securities.